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Submission on Electricity Industry Amendment Bill

To the Economic Development, Science and Innovation Committee

From the Electricity Networks Association

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1. Introduction

The Electricity Networks Association (**ENA**) appreciates the opportunity to make a submission to the Economic Development, Science and Innovation Committee on the Electricity Industry Amendment Bill (the Bill). This submission is on behalf of ENA's members (listed in Appendix B to this submission), the electricity distribution businesses (EDBs) of New Zealand. EDBs will play a critical role in supporting and enabling the decarbonsation and electrification of the New Zealand economy as the country responds to the challenges posed by climate change. This will in turn require EDBs to transform both the physical assets that make up their electricity networks, but also their operational and business practices, whilst continuing to manage the energy trilemma – providing consumers with a secure electricity supply, sustainably and affordably. It is therefore very important that the regulatory framework within which the EDBs work is appropriate and does not inadvertently stifle or inhibit the actions that EDBs need to transform their networks and businesses for the long-term benefit of consumers.

2. Executive Summary

ENA and its members are generally pleased to see the Government following through on the recommendations arising from 2019 Electricity Price Review, an initiative that EDBs engaged with extensively. ENA strongly supports the establishment of an electricity consumers' advocacy agency as we agree the regulation of the sector can be complex and difficult for lay individuals to engage with and, consequently, have their views considered and reflected in decision-making.

ENA notes that the Bill will move some key regulations related to arms-length rules from the Electricity Industry Act (the Act) into the Electricity Industry Participation Code (the Code). At a high level we support a flexible regulatory regime during this period of rapid change in the industry, however we have some concerns around vesting such significant powers in the Authority. It is therefore important that any use of these powers is made only when well-considered and when the benefits clearly outweigh the costs and impacts. On this specific point, we have proposed alternative drafting for the proposed legislation which will improve the Bill and provide useful guidance to the regulator in exercising these new powers.

ENA does not support the introduction of new powers to the Electricity Authority (the Authority) to regulate quality or information requirements for distributors, via terms and conditions for access to distribution networks. ENA has significant concerns that this 'double regulation' of quality by both the Commerce Commission (the Commission) and now the Authority could lead to situations where EDBs must choose which regulatory standard to achieve. ENA has to be shown any real-world examples of the problems caused by the 'gap' in regulation that this amendment purports to address.

ENA also wishes to point out that Parliament very deliberately provides the Commission with the role of setting both the quality targets for EDBs, as well as approving the revenue that EDBs can recover to deliver those quality outcomes. Providing the Authority with the ability to effectively set quality targets for EDBs, but not have the ability to allow EDBs to recover the revenue to deliver those quality outcomes, breaks this existing sensible paradigm.

3. Small Electricity Consumer Advocacy Agency

The Bill provides for the establishment of a small consumer advocacy agency to provide evidence-based advocacy.

ENA supports the establishment of a consumer advocacy agency, as enabled by the Bill. The electricity sector and the regulation that surrounds it is often complex and challenging for a lay-person to engage with. Nevertheless, it is important that the views and preferences of 'small' electricity consumers are taken into account as policy is developed and key decisions made. ENA has learnt from its own experience, via ENA's Consumer Reference Panel, how valuable direct engagement with electricity consumers can be when considering high-level policy trade-offs. ENA invited the then newly appointed chair of the government's Consumer Advocacy Council to join the July meeting of ENA's Consumer Reference Panel to allow her to gain an early insight into issues effecting electricity consumers. We are therefore encouraged to see the government empowering this critical input into the sector.

4. Protecting household and small business consumers

The Bill will give the Authority the additional objective of protecting the interests of household and small business consumers in their dealings with industry participants.

The ENA does not have a position on whether or not the Authority should have an additional objective of protecting the interests of household and small business consumers in their dealings with industry participants. However, some observations may be helpful.

The Bill would amend the Electricity Industry Act so that the Authority's current objectives become their 'main' objectives. The new additional objective is described in the amended legislation as just that – an 'additional' objective. This could be interpreted as making the new additional objective subservient, or of lesser priority, than the Authority's 'main' objective. If it is the Government's intention that the new additional objective should be subservient to the main objective, then this is all well and good. However, if these objectives are intended to have equal weighting – which we presume is the intent – then the drafting in the Bill should be amended to better reflect this.

Fundamentally, providing the Authority with both a main objective – itself consisting of three arms (competition, reliability and efficiency) – and a new additional objective is unnecessarily complex and confusing. If the Government's intent is to address some lapse in the way in which the Authority safeguards the interests of household and small business consumers, then this should be built into the Authority's main objective, rather than added as an additional objective.

It seems clear to us that in order for the Authority to act for the long-term benefit of consumers (as per its current objectives), it must also protect the interests of households and small business consumers. The existing objective and the proposed additional objective are therefore effectively synonymous – or at least very close to

synonymous. However, if we assume for the sake of argument that the existing and additional objective are not synonymous, then the question arises: in a situation where the long-term benefit of consumers is not the same as, or in conflict with, protecting the interests of household and small business consumers, what should the Authority do? Would it be to consumers' advantage for the Authority to sacrifice their long-term benefit for the sake of protecting their (presumably short-medium term) interests?

Finally, we would like to point out that ENA and its members interact with the Authority on an almost daily basis, and in practice we see the Authority give a great deal of weight to the interests of household and small business consumers in its decision-making, irrespective of what their legislated objective says. Some evidence of this is the recently revised *Consumer care guidelines*[1] and the Authority's 2020 strategy reset[2], which placed Consumer centricity as its first ambition. We therefore think the addition of the proposed new additional objective would make little, if any, practical difference to how the Authority carries out its role and functions.

5. Regulation to promote competition in evolving contestable markets

Part 3 of the Act provides for arm's-length rules applying to a person that is involved in a distributor and a generator, or a distributor and a retailer. This is because a person with such involvements could be a conduit for information or could exert influence that has the potential to lessen competition. The Bill will move these rules to the Code, enabling the Code to regulate such a person in a like manner, whether or not that person is an industry participant.

ENA notes that moving the arms-length rules from the Act to the Code provides the Authority with significant new powers to both relax existing restrictions on EDB involvement with generation and retail, but also potentially intrude further on the commercial freedom of EDBs to do so. Because of this potential, we propose some alternative drafting, written for the sector by Chapman Tripp, that gives guidance to the Authority on when and how these powers should be used. This alternative drafting, along with an explanatory cover note from Chapman Tripp, is provided as Appendix A to this submission.

As you will see in the Appendix, ENA is concerned that the Bill grants significant new powers to the Authority that historically have been the province of primary legislation and therefore only able to be amended by Parliament. At the same time, the proposed new legislation does not provide any guidance or instruction to the Authority on when or how these powers should be used. Our proposed alternative drafting, modelled on similar powers available to the Commission under the Commerce Act, goes some way to addressing this, whilst still being entirely consistent with the explanatory note and stated purpose of this element of the Bill.

[1] https://www.ea.govt.nz/assets/dms-assets/28/Consumer-Care-Guidelines.pdf

[2] https://www.ea.govt.nz/about-us/strategic-planning-and-reporting/strategy-reset-2020/

6. Regulating distribution access terms and conditions

The Bill will enable the Code to regulate distribution access terms and conditions as it already does for transmission.

ENA does not support providing for the Authority to amend the Code to regulate distribution access terms and conditions. ENA was not supportive of the Default Distributor Agreement (DDA) when it was proposed and enacted by the Authority, and we believe it still remains to be seen whether the imposition of the DDA has generated any benefit for the sector or consumers. We have long been concerned about the scope for the dual regulators of the sector (the Authority and the Commission) to 'tread on each others toes' and we believe that with this element of the Bill, this regulatory overlap will now occur.

We therefore have significant concerns that the sector will end up being 'double regulated' for price and quality by both the Authority and the Commission, which would put EDBs in a confusing, potentially lose-lose situation. If, for example, the Authority were to impose quality obligations on EDBs via the Code, but the Commission did not account for these obligations in the default price-quality path[3] process, then EDBs may be put in a position of having to decide which regulation to comply with and which one to breach.

That said, ENA is pleased to see that the Bill amends the Commerce Act to require that the Commission must take into account:

> *any provision of the Code, or decision made under it, that relates to or affects—*
> *(i) pricing methodologies that apply to a supplier of electricity lines services; or*
> *(ii) quality or information requirements that apply to a supplier of electricity lines services:*

Nevertheless, it would be preferable that the duplication of powers that this Bill introduces was avoided altogether. ENA is still unaware of any significant real-world problems that exist due to this 'gap' in the Authority's regulation of distribution via the Code.

7. Other matters

The Bill also provides for other matters that will improve the electricity regulatory system, including—

7.1. clarify the Authority's powers to gather information from industry participants for the purpose of carrying out reviews or investigations requested by the Minister

No comment.

[3] https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-lines-price-quality-paths/electricity-lines-default-price-quality-path

7.2. enable the Authority to exempt an industry participant from compliance with the Code on any terms and conditions that it reasonably considers are necessary

ENA supports this element of the Bill.

7.3. enable the Authority to revoke Code amendments that were made under urgency under a shortened process

ENA is supportive of this element of the Bill. ENA notes, however, that there is a potential for the Authority to make more Code amendments under urgency than it otherwise would, if the process to revoke those amendments is more accessible. Based on experience, ENA believes urgent Code amendments should be made only in the most extreme of situations, and only as a last resort. ENA does not, for example, think that the urgent Code amendments made by the Authority in May 2020 were a sensible use of this existing power.

7.4. allow the Authority to share information with other public service agencies and statutory entities

No comment.

7.5. enable the Minister to amend the Code if the Minister is not satisfied with progress on specified matters

ENA does not support granting these additional powers to the Minister to amend the Code. We are pleased to see these powers are significantly time and scope limited. However, we question the fundamental reasons for reserving these powers for the Minister. The language used in the explanatory section of the Bill describes these new powers as being used:

> *"…if the Minister is not satisfied with progress on specified matters:"*

However, the actual clause to be inserted into the Act is as follows:

> *"(1) The Minister may amend the Code … if the Minister—*
>
> *a) considers that the Code's provisions for the specified matter are not satisfactory"*

The explanatory note is therefore somewhat misleading – the situation that might trigger the Minister's intervention is not a question of progress (i.e. timeliness), rather it is a question of whether or not the Minister is satisfied with the Code's provisions. This introduces a significant level of uncertainty as to what would trigger

the Minister to intervene, as it is based entirely on the subjective metric of the Minister's satisfaction with the Code.

Presumably the Minister's satisfaction will be determined by whether or not a particular Code provision delivers outcomes that are consistent with the Minister's (and by extension, government's) political objectives. It is difficult to envisage the Minister being dissatisfied to the extent of wishing to directly amend the Code, simply due to some technical or bureaucratic minutiae in the text of the Code.

Currently, the Authority is obliged to have *"…regard to any statements of government policy… that are issued by the Minister"*[4]. If the Minister has particular policy outcomes that he or she wishes to see achieved, the correct approach would be to issue a government policy statement to that effect, which the Authority must then have regard to in performing its functions. This is how many independent regulators work across the public sector and it has served New Zealand well.

Given that the option of making a policy statement has always been available to the Minister, the only conclusion can be that this new power is to allow the Minister to direct the way in which outcomes will be achieved, not merely what those outcomes should be.

This then raises the question, is the Minister (or more realistically the Minister's office) more competent to decide how policy outcomes should be achieved in the electricity sector than the Authority? And, if so, shouldn't that expertise be vested in the Authority at the outset, rather than being applied to Code provisions retrospectively by the Minister? If not, is it sensible for the Minister to then override the Authority's carefully considered approach to achieving policy outcomes?

New Zealand has a long history of independent, expert regulators guided by primary legislation, protected from Ministerial interference in their day-to-day activities. We see no good reason to depart from this approach and therefore do not support these additional powers to the Minister.

7.6. clarify the impact of the Code on the regulation of Transpower and electricity distributors under Part 4 of the Commerce Act 1986.

ENA supports the proposed amendment to the Commerce Act that will require the Commission to have regard to obligations imposed on EDBs by the Code when carrying out its functions. However, as noted above in our response to the regulation of distribution access terms and conditions, we are concerned by the introduction of 'double regulation' of the sector. The Electricity Industry Act that established the Authority was very careful to ensure that the Authority could not regulate anything already regulated by the Commission[5]. In introducing these elements of this Bill, the government appears to be abandoning this very sensible division of regulatory powers for the purpose of filling a perceived 'gap' in regulatory oversight, the existence of which does not appear to have generated any real-world negative effects.

[4] Electricity Industry Act 2010, Section 17, Clause 1.

[5] Electricity Industry Act 2010, Section 32, Clause 2(b).

8. Contact

The ENA's contact person for this submission is Richard Le Gros (richard@electricity.org.nz or 04 555 0076).

9. Appendix A – Alternative drafting for Section 32 of amended Electricity Industry Act

[See overleaf]

EIAB – DRAFTING SUGGESTIONS FOR CORPORATE SEPARATION / ARM'S-LENGTH RULES

1 Set out below is our drafting proposal for section 32 of the Electricity Industry Act 2010. The mark-up is shown against the amended s 32 in the Electricity Industry Amendment Bill (***EIAB***).

2 Our concern with the EIAB as it currently stands is that it delegates to the Authority the power to determine matters that have historically, for good reason, been the province of primary legislation, and it does so without providing any guidance to the Authority regarding the manner in which that power should be exercised, or the matters to which the Authority should have regard.

3 Part 3 (EIRA, as it was then) was the product of an extensive policy process, as a consequence of which Parliament determined that the risks to competition from allowing natural monopoly lines companies to operate vertically integrated generation and retail businesses were so substantial that the best approach was to require separation of those elements of the supply chain entirely. EIRA was passed as part of a comprehensive intervention in the structure of the industry, including divestments and structural separation of previously vertically integrated businesses.

4 Mandating separation is a significant intrusion on commercial freedom and private property rights, which is why in the past it has always been a matter for primary legislation. The most significant examples in the utilities sector in New Zealand are EIRA and the operational and then structural separation of Telecom. Both involved primary legislation given the nature of the intervention.

5 If a similar power is to be delegated to the Authority then, <u>at a minimum</u>, we would reasonably expect that the legislation:

5.1 clearly articulate the power that has been granted to the Authority and the purpose for which it must be exercised; and

5.2 the considerations that the Authority must take into account when exercising that power.

6 The explanatory note to the Bill explains that the intent is to empower the Authority to make rules to prevent lines companies from distorting competition in adjacent competitive markets. The suggested drafting below makes this explicit, and outlines the considerations that we would expect the Authority would have regard to when assessing the competition implications of the status quo in order to justify intervention.

32 Content of Code

(1) The Code may contain any provisions that are consistent with the objectives of the Authority and are necessary or desirable to promote any or all of the following:

(a) competition in the electricity industry:

(b) the reliable supply of electricity to consumers:

(c) the efficient operation of the electricity industry:

(d) the protection of the interests of domestic consumers and small business consumers in relation to the supply of electricity to those consumers:

(e) the performance by the Authority of its functions:

(f) any other matter specifically referred to in this Act as a matter for inclusion in the Code.

(2) The Code may not—

(a) impose obligations on any person other than an industry participant or a person acting on behalf of an industry participant, or the Authority (other than in accordance with **subsection (3)**); or

(b) purport to do or regulate anything that the Commerce Commission is authorised or required to do or regulate under Part 4 of the Commerce Act 1986 (other than in accordance with **subsection (4)**); or

(c) purport to regulate any matter dealt with in or under the Electricity Act 1992.

(3) Subject to **subsection (3A)**, ~~The~~ the Code may impose obligations on industry participants or specified persons for the purpose of restricting relationships between 2 classes of industry participants, where those relationships may not otherwise be at arm's length and as a consequence competition in the electricity industry is likely to be substantially lessened.

(3A) Before making any provision under **subsection (3)**, the Authority must be satisfied:

(a) there is scope for the exercise of substantial market power by distributors or Transpower in relation to the supply of goods or services other than line function services, as a result of which competition for the supply of those goods or services is likely to be substantially lessened, taking into account the effectiveness of existing regulation or arrangements (including ownership arrangements); and

(b) the benefits of restricting relationships between classes of industry participants materially exceed the costs of those restrictions, having regard to:

(i) material effects on allocative, productive, and dynamic efficiency;

(ii) material distributional and welfare consequences on suppliers and consumers; and

(iii) the direct and indirect costs and risks of any type of regulation considered, including administrative and compliance costs, transaction costs, and spill-over effects.

(4) The Code may contain provisions that do any of the following, regardless of whether such a provision would otherwise be prohibited under **subsection (2)(b)**:

(a) set quality or information requirements for Transpower or 1 or more distributors, in relation to the terms and conditions for access to transmission or distribution networks:

(b) set pricing methodologies for Transpower or 1 or more distributors.

(5) **Subsections (3) and (4)** do not limit **subsection (1)**.

(6) In this section,—

Commented [CT1]: The EIAB doesn't include a specific empowering provision. Rather, it relies on the general empowering provision in subsection (1). Subsection (3) extends the Code-making power to non-industry participants. We have suggested making subsection (3) a specific empowering provision in relation to separation and arm's length rules.

Commented [CT2]: Makes explicit the purpose for which the power is conferred on the Authority.

Commented [CT3]: This is adapted from the Commission's Part 4 inquiry power in the Commerce Act, on the basis that is an existing model for how to undertake a regulatory intervention on competition grounds.

Commented [CT4]: Makes explicit that the concern is with lines companies leveraging their market power into adjacent contestable markets.

Commented [CT5]: The Authority must demonstrate that there is an actual risk to competition; i.e. it is not enough that the Authority apprehends a theoretical risk that it wishes to pre-emptively address.

Commented [CT6]: For example: (i) Part 2 of the Commerce Act addresses restrictive trade practices including abuse of dominance, (ii) Part 3 prohibits anticompetitive acquisitions and mergers, (iii) the related parties rules under Part 4 require that transactions with a related party (including an unregulated part of the regulated business) are on demonstrably arm's length terms.

Commented [CT7]: This is similar to the considerations the Commission takes into account when doing a Part 4 inquiry.

pricing methodologies has the meaning given in section 52C of the Commerce Act 1986

specified person means a person (other than an industry participant) who is involved in both classes of industry participant that are the subject of any provisions made in accordance with subsection (3).

10. Appendix B – ENA Members

The Electricity Networks Association makes this submission with the support of its members, listed below.

Alpine Energy

Aurora Energy

Buller Electricity

Centralines

Counties Energy

Eastland Network

Electra

EA Networks

Horizon Energy Distribution

MainPower NZ

Marlborough Lines

Nelson Electricity

Network Tasman

Network Waitaki

Northpower

Orion New Zealand

Powerco

PowerNet

Scanpower

The Lines Company

Top Energy

Unison Networks

Vector

Waipa Networks

WEL Networks

Wellington Electricity Lines

Westpower