Budget 2023 Submission for Invited New Spending Priorities and CERF Initiatives

Section 1: Overview

Section 1A: Basic initiative information

Initiative title (max 120 characters)	Fuel regulatory backstop implementation		
Lead Minister	Minister of Energy and Resources	**Agency**	Ministry of Business, Innovation and Employment/Commerce Commission
Initiative description (max 800 characters)	The Fuel Industry Amendment Bill will establish a regulatory backstop for the terminal gate price requirements in the Fuel Industry Act 2020. The Bill is intended to promote wholesale competition in engine fuel markets for the benefit of fuel consumers by creating a credible threat of regulation of terminal gate prices where those prices are found to be excessive. The Commerce Commission will be responsible for administering the regulatory backstop, which will include analysing terminal gate prices, making recommendations to the Minister on whether certain terminal gate prices should be regulated, and setting regulated pricing methods for those terminals. This is a significant new function that is not currently funded. This new function is expected to commence in July 2023.		
Priority area	New Spending – Invited operating initiatives ☒	New Spending – Invited capital initiatives (outside the Investment Panel process) ☐	Climate Emergency Response Fund (CERF) ☐
Is this a cross-Vote initiative?	***No***	*If yes, indicate which other Votes are affected.*	
Department contact	**Commerce Commission:** *Name:* Scott Pearse-Smith *Phone:* Privacy *Email:* scott.pearse-smith@comcom.govt.nz **MBIE:** *Name:* Laura Davidson *Phone:* Privacy *Email:* laura.davidson@mbie.govt.nz	**Treasury contact (Vote Analyst)**	*Name: Taylor Farr* *Phone:* *Email: Taylor.Farr@treasury.govt.nz*

Section 1B: Summary of funding profile

Operating funding sought through Budget 2023 ($m)					
2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears***	**Total**
-	1.001	1.493	1.493	1.493	**5.480**

Capital funding sought through Budget 2023 ($m)										
22/23	**23/24**	**24/25**	**25/26**	**26/27**	**27/28**	**28/29**	**29/30**	**30/31**	**31/32***	**Total**
-	-	-	-	-	-	-	-	-	-	**-**

Section 2: Alignment

Section 2A: Problem definition

The answer to each question must not exceed 2-3 paragraphs

What is the problem that this initiative is trying to solve and why does it need to be solved now?	The Commerce Commission will be allocated a new statutory function in July 2023 – administering the regulatory backstop to the fuel terminal gate pricing regime. The function is currently unfunded, and therefore unlikely to achieve the Government's policy intent. The purpose of the new regulatory backstop function is to put downward pressure on fuel prices by establishing a credible threat of regulation where

	wholesale suppliers are found to be setting excessive terminal gate prices. This policy will only be effective if the Commission is properly funded to administer the regulatory backstop. Otherwise, wholesale suppliers will not see the threat of further regulation as credible and the regulatory backstop may not have its intended effect of putting downward pressure on fuel prices. In considering policy on the Fuel Industry Amendment Bill (which will introduce the Commission's regulatory backstop function), Cabinet agreed in August 2022 that new ongoing funding is required for the Commerce Commission to implement the regulatory backstop, to be sought as part of Budget 2023 [DEV-22-MIN-0170 refers]. Fuel is a significant direct cost for nearly all households and businesses. It is also a significant indirect cost, in that fuel prices are an input to many other goods and services purchased by households and businesses in the NZ economy. As such, the impact of even a very small reduction in fuel prices is significant. The Commission's recent quarterly fuel competition monitoring report indicated that terminal gate prices in New Zealand look very high when compared against several benchmarks. (Note: an expanded description of the problem definition is attached to this template.)
	The Commerce Commission has two existing roles under the Fuel Industry Act – enforcing the requirements of the Act and monitoring competition in fuel markets. The Commission received funding in Budget 2021 to establish a team to deliver these functions, which is now up and running. The Fuel Industry Amendment Bill will add a third significant function: administering the regulatory backstop. This will include: • analysing terminal gate prices to determine when to undertake an inquiry; • undertaking inquiries to inform recommendations to the Minister on whether certain terminal gate prices should be regulated; and • setting regulated pricing methodologies for any terminal gate prices that the Minister declares as regulated. This new function is not currently funded. (Note: the Budget 2021 bid referred to above explicitly excluded the cost of administering any regulatory backstop, which had not been fully developed at the time of that bid). If it remains unfunded, the Commission will be faced with either not proactively administering the regulatory backstop, which would not deliver on the policy intent of the Bill; or diverting resources from other areas, which would have knock-on impacts on the ability of the Commission to deliver competitive and well-regulated markets in other areas. See section 3C for more on the impacts of not receiving funding.
	The development of a regulatory backstop to the terminal gate price regime was part of the package of recommendations made by the Commerce Commission in its 2019 fuel market study. The Commission consulted extensively in carrying out its market study and developing its recommendations, which included a recommendation to establish a regulatory backstop to the terminal gate price regime. As part of MBIE's March 2020 industry consultation paper (*Regulations under a Fuel Industry Bill and other matters),* MBIE sought views on the design of a regulatory backstop. MBIE recommenced work on designing the regulatory backstop in 2022. In doing so, MBIE consulted the Commerce Commission, Ministry of Justice, Treasury, Ministry of Transport, Ministry of Primary Industries, Ministry for the Environment, Ministry of Foreign Affairs and Trade, Waka Kotahi and the Office of the Privacy Commissioner. Department of the Prime Minister and Cabinet were kept informed. These views helped to inform the policy design of the regulatory backstop, which was agreed to by Cabinet on 3 August 2022 [DEV-22-MIN-0170 refers]. Cabinet also agreed that new ongoing funding is required for the Commerce Commission implement the regulatory backstop, to be sought as part of Budget 2023.
	As above, the development of a regulatory backstop to the terminal gate price regime was part of the package of recommendations made by the Commerce Commission in its 2019 fuel market study. The Commission consulted extensively in carrying out its market study and developing its recommendations. MBIE recommenced work on designing the regulatory backstop in 2022. In doing so, MBIE consulted the Commerce Commission, Ministry of Justice, Treasury, Ministry of Transport, Ministry of Primary Industries, Ministry for the Environment, Ministry of Foreign Affairs and Trade, Waka Kotahi and the Office of the Privacy Commissioner. Department of the Prime Minister and Cabinet were kept informed.
What needs to improve and/or change to address the problem?	The Commerce Commission needs additional funding to carry out the new regulatory backstop function that it will be responsible for under the Fuel Industry Amendment Bill. **Ensuring the Commission is properly funded to monitor terminal gate prices and assess whether/when to invoke the regulatory backstop process** The Commerce Commission will need to employ one additional FTE to support analysis of, and reporting on, terminal gate prices on an ongoing basis. This will support advice to Commissioners on whether to commence an inquiry into terminal gate prices at particular locations. The Commission will also incur costs to the Commission's data systems to facilitate the analysis and monitoring that would be required to meet the expectations of the Commission's new regulatory backstop function.

	Ensuring the Commission is properly funded to invoke and carry out the regulatory backstop process In addition, the Commission will need sufficient funding to be able to invoke the regulatory backstop process where monitoring suggests that this would be warranted (or where directed to by the Minister). This would involve: • Undertaking inquiries into whether terminal gate prices should be regulated at particular locations – this would include significant information collection, analysis and consultation in relation to whether the prices posted by wholesale suppliers were consistent with what would be expected in a workably competitive market. • Where, as a result of a Commission inquiry, the Minister decides to declare certain terminals regulated, the Commission would be required to set the pricing methods or principles that wholesale suppliers must apply. This would again involve information collection, analysis and consultation in order to set an appropriate pricing method or principle. • The Commission will also then need to monitor compliance with, and enforce where necessary, those pricing principles or methods. The Commission will also need to monitor the effectiveness of those regulated pricing principles or methods and amend them (after consulting) where necessary. This process would require additional resources of 4.7 FTE, plus external costs (for expert legal, economic, industry input), each time it is invoked. It is difficult to predict how frequently the Commission will need to invoke the regulatory backstop process, as it will depend to a large extent on the pricing behaviour of the wholesale suppliers. However, for the regulatory backstop to achieve its intent of incentivising wholesale suppliers not to price excessively so as to avoid further regulation, the Commission ought to be funded (and must be seen by industry to be funded) to be able to readily invoke the regulatory backstop process at least once per year.

Section 2B: Alignment

Alignment to the Wellbeing Objectives and the economic plan	Funding the Commission to be able to implement the regulatory backstop is intended to place downward pressure on wholesale fuel prices and, in turn, retail fuel prices. Fuel is an essential and significant item of household expenditure and a significant input cost for businesses. $10 billion worth of fuel is sold at service stations in New Zealand every year. Despite the increasing adoption of electric vehicles, the majority of New Zealanders will continue to be reliant on petrol and diesel for years to come. As such, this initiative aligns with the Government's 'Just Transition' Wellbeing Objective by helping to ensure fuel prices remain reasonable while the transition takes place. It also aligns with the 'strengthen our foundations' limb of the Government's economic plan. Fuel is an essential and significant cost for consumers and businesses and is a foundation for economic activity in New Zealand. Strengthening the regulation of the fuel sector to drive competition will help ensure that New Zealand consumers and businesses are not paying more than they should for this essential item of expenditure.
Specific implications regarding the Crown's obligations under the Treaty of Waitangi	There are no specific implications regarding the Crown's obligations under the Treaty of Waitangi.

Section 3: Value

Section 3A: Benefits and outcomes

What outcome(s) would the initiative achieve?	This initiative benefits the 'income and consumption' wellbeing domain. It places downward pressure on fuel prices, which in turn means that households and businesses face lower fuel prices than they otherwise would have. Fuel is a significant direct cost for nearly all households and businesses. It is also a significant indirect cost, in that fuel prices are an input to many other goods and services purchased by households and businesses in the NZ economy. As such, the impact of even a very small reduction in fuel prices is significant. To help give a sense of magnitude: • $10 billion worth of fuel is sold at service stations in NZ every year. (Source: ComCom Market Study) • Wholesale prices and profits have been higher than would be expected in a competitive market. This flows through to consumers paying higher pump prices. (Source: ComCom Market Study) • Fuel companies have been making persistently higher profits than would be expected in a workably competitive market, which supports the view that prices would be lower if improvements in competition are

<table>
<tr><td rowspan="2"></td><td colspan="6">achieved through the proper monitoring and enforcement of the interventions established by the Fuel Industry Act. The market study found that, between 2016 and 2018, fuel companies in NZ made $400 million in excess profits per year (see Figure C9 of ComCom Market Study). The study also found that New Zealand's listed fuel company's (Z Energy) net margin per litre is double that of listed fuel companies in Australia (see para C244 of the Market Study).
• New Zealand is heavily reliant on motor vehicles. We own a lot of cars per capita compared to other countries and spend a large share of our income on fuel. (Source: ComCom Market Study).
• The average NZ household spends 4.6% of income on petrol. (Source: Stats NZ, 2022)</td></tr>
<tr><td colspan="6">This initiative will allow the Commission to analyse, on an ongoing basis, whether wholesale fuel suppliers' terminal gate prices are consistent with what would be expected in a competitive market. Where the Commission's analysis reveals concerns (or where directed by the Minister), the Commission could then conduct an inquiry into whether the terminal gate prices should be regulated. Through its monitoring and inquiries, the Commission will be able to evaluate whether the regulatory backstop, and the funding provided through this initiative, have delivered on their intent – ie, to incentivise wholesale suppliers to set competitive terminal gate prices.
Where the Commission conducts an inquiry, the Minister imposes regulation, and the Commission then sets a regulated pricing method or principle. This initiative will allow the Commission to monitor the effectiveness of the regulated pricing method/principle on an ongoing basis. Where this evaluation finds that the regulated pricing method/principle could be improved, this initiative would allow the Commission to amend its price determination to improve its effectiveness (after consulting).</td></tr>
<tr><td rowspan="2">**Distributional/system impacts**</td><td colspan="6"></td></tr>
<tr><td>☒
Māori</td><td>☒
Pacific Peoples</td><td>☒
Child Poverty</td><td>☐
Women and Girls</td><td>☒
Environment</td><td>☒
Regulatory Systems</td></tr>
<tr><td>**Timeframes**</td><td colspan="6">The key benefits of this initiative are expected to be realised in the short, medium and long term. Establishing the fuel regulatory backstop in legislation and properly funding the Commission to use it will incentivise wholesale fuel suppliers to ensure that the terminal gate prices are not excessive. This incentive effect should take effect in the short term and continue into the medium and long term.
Note 1: This initiative may also have indirect positive impacts on Māori, Pacific Peoples and child poverty. This is because it will put downward pressure on fuel prices, and fuel costs make up a greater share of household expenditure for lower income households.
Note 2: This initiative may have minor indirect negative impacts on the environment. However, because fuel is a relatively inelastic good, any reduction in fuel margins (and therefore prices) as a result of the Commerce Commission's work is unlikely to have any appreciable impact on emissions. Also, fuel is part of the emissions trading scheme, so there should be no impact on net emissions.</td></tr>
<tr><td>**Evidence and assumptions**</td><td colspan="6">In 2019, the Commerce Commission completed a year-long study into competition in the fuel market. That study found that:
• Roughly 3.2 billion litres of petrol and 2.6 billion litres of diesel are purchased are purchased at service stations, unmanned sites and truck stops in New Zealand each year. This amounts to a $10 billion spend every year by consumers of fuel in New Zealand.
• Between 2016-2018, fuel companies made excess profits of $400 million per year.
• New Zealand's listed fuel company's (Z Energy) net margin per litre is double that of listed fuel companies in Australia.
The figures above illustrate the magnitude of the potential benefits of successfully incentivising wholesale fuel suppliers to set terminal gate prices that reflect a reasonable return.
Further, the Commission recently published its first quarterly monitoring report under the Fuel Industry Act. That report indicated that terminal gate fuel prices in New Zealand look very high when compared against several benchmarks:
• in comparison to Australia, adjusted for differences in taxes and exchange rates
• in comparison to contract prices, where average terminal gate prices range from 10 to 23 cpl higher than wholesale contract prices; and
• in comparison to retail prices, where terminal gate prices range from 6 to 8 cpl lower than the average discounted retail board prices.
That report noted some of the considerations that could be usefully considered by further monitoring and analysis of terminal gate prices.
MBIE's Supplementary Analysis Report on the regulatory backstop policy proposals also contains the further evidence and assumptions it relied upon in developing the regulatory backstop policy proposal.</td></tr>
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Section 3B: Expenditure profile and cost breakdown

Formula and assumptions underlying costings

In order to provide a credible threat that the backstop may be imposed if wholesale suppliers set excessive terminal gate prices (and also allow the Commission to meet its statutory obligations), this initiative seeks funding that would:

1. Allow the Commission to analyse and report on terminal gate prices in a way that supports informed decision-making on whether/when to invoke the backstop process. These costs will be incurred every year.
2. Allow the Commission to invoke the regulatory backstop once a year (noting that this funding may not be spent if not needed in a given year).
3. Allow the Commission to administer price regulation on an ongoing basis once it has been imposed (i.e. once the backstop has been invoked for the first time and regulated pricing methods or principles imposed, there will be ongoing costs associated with administering that regulation – such as compliance and enforcement, and amending price determinations as required).

1. Costs incurred every year:

- 1 additional FTE (Senior Analyst) in the Commission's Fuel Regulation team on a permanent basis to work on analysing and reporting on terminal gate prices.
- Commissioner wages to support Commissioner consideration of terminal gate prices and make decisions on whether to invoke the regulatory backstop process
- External costs to support ongoing updates to the Commission's data systems to facilitate the analysis and monitoring that would be required to meet the expectations of the Commission's new regulatory backstop function.

2. Costs incurred each time the regulatory backstop is invoked (by the Commission or the Minister):

- 4.7 fixed-term FTE
  - 1x Senior Analyst
  - 1 x Chief Adviser
  - 1 x Project Manager
  - 0.5 Senior Legal Counsel
  - 0.5 Senior Economist
  - 0.35 Senior Communications Adviser
  - 0.35 Business Partner (to support the administration associated with bringing on board a project team such as this)
- Commissioner wages (400 hours in 2023/24; 600 hours pa thereafter) to support Commissioner oversight and decision-making in relation to the regulatory backstop process. (Note: By statute, the functions, duties and powers of the Commission are typically required to be exercised by Commissioners).
- 9(2)(j)

3. Once the backstop has been invoked for the first time and regulated pricing methods or principles imposed, there will be ongoing costs associated with administering that regulation. For example, the Commission will need to:

- monitor compliance with the regulated pricing methods or principles
- take enforcement action where necessary
- continue to assess whether the regulated pricing methods or principles remain fit for purpose, and make any necessary amendments.

The costing includes overhead costs for the expenses associated with hiring staff (including IT equipment and licences, office equipment and office space). If this new function does not pay its share of overheads, then those costs would need to be met out of existing funds, which means other Commission functions would need to pick up a greater share of overheads, with a knock-on reduction in the ability of those functions to deliver competitive and well-regulated markets.

What happens if the regulatory backstop is not invoked?

While funding annual funding for the regulatory backstop regime is necessary to establish a credible threat that the backstop process may be invoked, the backstop process may not be initiated annually. Currently, unspent funds against the Fuel Monitoring and Enforcement category may be retained by the Commission in its reserves. The Commission proposes to not draw down the full funding associated with the backstop regime unless the process is initiated to ensure these funds are not retained unnecessarily.

Commentary on the cost breakdown is provided above.

Operating expenses ($m)						
Operating expense category	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears***	**Total**
New FTE wage funding (Commerce Commission)	9(2)(j)					
Data Systems Maintenance and Enhancement (externally sourced)						
External consultants (legal, economic, and industry experts)						
Total ($m)	**-**	**1.001**	**1.493**	**1.493**	**1.493**	**5.480**

# of new FTEs (incl. contractors) over the forecast period	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**Total**
	-	3.8	5.7	5.7	5.7	5.7

Capital expenses ($m)											
Capital expense category	**22/23**	**23/24**	**24/25**	**25/26**	**26/27**	**27/28**	**28/29**	**29/30**	**30/31**	**31/32***	**Total**
Total ($m)	-	-	-	-	-	-	-	-	-	-	**-**
*Extend the profile above if funding is needed beyond 2031/32.											

Section 3C: Options analysis

What were the range of options considered?	If new funding is not provided for the Commerce Commission to administer the regulatory backstop (as requested in this bid), the options are: 1. Using the funding already appropriated for the Commerce Commission's work under the Fuel Industry Act to meet the costs of administering the regulatory backstop. This would compromise the Commission's ability to properly deliver on its existing functions under the Fuel Industry Act and its ability to achieve the purpose of the Act, which is to promote competition in fuel markets for the long-term benefit of fuel users. For example, this might mean the Commission is forced to divert resources away from assessing wholesale contracts for anti-competitive terms. This would undermine the existing interventions established by the Fuel Industry Act 2020, and undermine the Budget 2021 initiative to fund the Commission to administer those interventions. 2. Not actively administering the fuel regulatory backstop. The Commerce Commission could choose not to self-initiate inquiries into whether to recommend regulation of terminal gate prices. (However, the Minister could still direct the Commission to undertake an inquiry, which would see the Commission in the situation described under option 1 or option 3.) This risks the regulatory backstop failing to deliver on its intent, which is to put downward pressure on fuel prices by incentivising wholesale fuel suppliers to set competitive terminal gate fuel prices. It could also mean that the Commission fails to properly discharge its statutory functions, which could have legal and/or reputational consequences for the Commission – which in turn impacts on the Commission's ability to effectively deliver on its other areas of responsibility. 3. Seeking a fiscally neutral transfer of funding from one of the other categories in the Enforcement of General Market Regulation MCA to the Liquid Fuels Monitoring and Enforcement category to able to deliver the regulatory backstop, in addition to the Commission's existing functions under the Fuel Industry Act. However, this would impact on the Commission's ability to deliver on its powers, duties and functions and meet expectations in other areas of its work (i.e. beyond its fuel work) and reducing its ability to deliver competitive and well-regulated markets in those areas.
What was the process used to select the preferred option?	The risks associated with each option were assessed, as summarised in the row above. The cost of the preferred option (i.e. funding the Commission to administer the regulatory backstop) is $1.500 million pa. The other options (1-3 above) have no immediate monetary cost but may have significant costs for consumers and the NZ economy (in terms of foregone benefits) if they compromise the Commission's ability to deliver the regulatory backstop function or the Commission's other functions.

	The benefit of options 1-3 is that they do not involve additional Crown funding (i.e. they 'save' $1.500 million pa) – but this comes with the costs outlined above.
	The assessment of the costs and benefits of the options was performed by the Commerce Commission, with review by MBIE.
	N/A
	Because it: • Funds the Commission to deliver a function that it is required by statute to deliver, which preserves the integrity of the law and the reputation and effectiveness of the Commerce Commission. • Is critical to achieving the policy intent of the Government's decision to introduce a regulatory backstop – something the Government has invested considerable effort into developing and progressing through the form of the Fuel Industry Amendment Bill. (That policy intent is to put downward pressure on fuel prices by incentivising wholesale fuel suppliers to set reasonable terminal gate prices.) • Puts downward pressure on fuel prices, which is likely to have benefits across the economy that outweigh the cost of the initiative. • Avoids the risks outlined above that are associated with the other options.
	As above, the costs (in terms of foregone benefits) associated with alternative options 1-3 above are significant but difficult to quantify. It is highly likely that those costs would outweigh the benefit of 'saving' the Crown $1.500 million by not funding the Commission to deliver this new statutory function that is expected of it.
Counter-factual question	These are the same as the options outlined in the first row of this section.

Section 3D: Scaled option

Scaling option overview	A scaled option would be to provide the Commission with $1.000 million pa for its new regulatory backstop function instead of the preferred $1.500 million. This would still allow the Commission to actively monitor and assess terminal gate prices – in order to allow informed decisions to be made on whether to invoke the regulatory backstop process. It would also allow the Commission to invoke the regulatory backstop process and carry out inquiries and price-setting. However: • These backstop processes would be slower, less frequent, and/or reduced in scope (e.g. targeting inquiries at a smaller number of wholesale terminals, fuel types or suppliers). • The Commission may need to retain (i.e. roll forward) a larger share of the funding each year to ensure that, when it does need to invoke the backstop process, it has sufficient funds to do so.
	Because this option would still allow the Commission to actively monitor whether to invoke the regulatory backstop process, and to invoke the process where warranted (albeit more slowly, less frequently, and/or with reduced scope), it would establish a threat of further regulation, albeit less credible, that should incentivise wholesale suppliers not to set excessive terminal gate prices. In that sense, this scaled option still supports the Government's policy intent for the regulatory backstop – but not as well (as it reduces the credibility of the threat and therefore the strength of the incentive on wholesale suppliers, as compared to the preferred option). Wholesale suppliers will know that invoking the regulatory backstop would be a resource-intensive exercise for the Commission (owing to the process requirements, complexity of the analysis and decisions required, and the prospect of legal challenge), so if they perceive that the Commission is not adequately funded to invoke the backstop (or is likely only to do so in extreme circumstances), that reduces the incentive on them to set reasonable terminal gate prices. If the reduced level of funding does make wholesale fuel suppliers more comfortable 'testing the limits' of the terminal gate prices they can get away with, that could result in fuel prices that are higher than they would be if the initiative were fully funded.

	This option scales back the resourcing that would be used when the regulatory backstop is invoked:
	• 4.7 fixed-term FTE months is reduced to 2.5 fixed-term FTE each time the backstop is invoked:
	    o 1 x Chief Adviser
	    o 0.5 Senior Legal Counsel
	    o 0.5 Senior Economist
	    o 0.25 Senior Communications Adviser
	    o 0.25 Business Partner
	• There is a corresponding reduction in overheads ($0.185 million to $0.111 million)
	• Commissioner wages are reduced from 600 hours to 400 hours pa

	• 9(2)(j) The other costs are the same as for the preferred option.

Operating expenses ($m)						
Operating expense category	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears***	**Total**
New FTE wage funding (Commerce Commission)	9(2)(j)					
Data Systems Maintenance and Enhancement (externally sourced)						
External consultants (legal, economic, and industry experts)						
Total ($m)	**-**	**1.000**	**1.000**	**1.000**	**1.000**	**4.000**

# of new FTEs (incl. contractors) over the forecast period	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**Total**
	-	3.5	3.5	3.5	3.5	3.5

Capital expenses ($m)											
Capital expense category	**22/23**	**23/24**	**24/25**	**25/26**	**26/27**	**27/28**	**28/29**	**29/30**	**30/31**	**31/32***	**Total**
Total	-	-	-	-	-	-	-	-	-	-	**-**

Section 4: Delivery

Section 4A: Procurement and workforce requirements

The answer to each question must not exceed 2-3 paragraphs.

What is the initiative purchasing/funding?	The $1.500 million pa sought through this initiative would support recruitment of the necessary analytical, legal, economics, project management and fuel industry expertise. It would also support the engagement of experts (legal, economic, fuel industry), as is typically required for complex regulatory analytical and decision-making processes such as the regulatory backstop process. It would also support the ongoing changes that the Commission will need to make to its data management processes to facilitate the analysis that would be required to meet the expectations of the Commission's new regulatory backstop function.
Is there a market that can meet these needs?	The national and international labour and consulting market. The Commerce Commission often recruits/procures from the national and international labour and consulting market for economic, legal and regulatory experts, so is familiar with the market.
	The Commission is highly regarded in the labour market. The Commission does not generally face difficulty in recruiting high calibre employees. In recent times, the Commission has generally been able to recruit additional staff in a tight market for skilled people, but some more specialised positions have taken longer to fill (in part due to recent limitations on recruitment from abroad).
	The following skills are required: • Legal • Economic • Analytical • Fuel Industry • Project management.

	The Commerce Commission has recent experience recruiting each of these skillsets and has generally been successful in attracting the skills needed. As explained in section 3B, only a small portion of these resources will be required on an ongoing basis. The majority of the resources described above will only be required when the backstop process is initiated. Where the backstop process is initiated by the Commission, that will give the Commission time to prepare for bringing the necessary resources on board. Where the backstop process is initiated by the Minister, the Commission may have to establish the project team for the backstop process at shorter notice. The Commission is confident it could move quickly to establish the project team under either scenario, particularly with the support of a Business Partner.
	Specific people have not yet been identified or approached.
	Other policy and regulatory agencies, such as the Reserve Bank, Financial Markets Authority and MBIE will be competing for similar resources. However, the Commission's point of difference is its focus on competition and economic regulation, for which there is less direct competition in New Zealand.
Government Procurement Rules	Yes.

Section 4B: Risks, constraints, and dependencies

What are the main risks?	**Risk 1: The funding sought is insufficient to meet the costs of the regulatory backstop process**. This risk is greatest the first time that the Commission invokes the backstop, but could also arise where the Commission is required to undertake more frequent, or larger, inquiries than assumed in the development of this bid. The first inquiry and price-setting process the Commission undertakes will have a strong precedent value and be critical in maintaining the credibility of the regulatory threat that the backstop is intended to create. The first inquiry and price-setting processes will also involve considerable effort for the Commission in establishing its framework and approach to these activities, which are likely to be closely scrutinised and challenged by stakeholders. This risk can be mitigated by the Commission's ability to carry forward an underspend in the fuel appropriation from one year to the next. If this risk eventuates in the first year of the new function (i.e. 2023/24), the Commission may need to scale back its other fuel regulatory activities to support a successful first backstop process, but this presents its own risks (as identified elsewhere in this template). **Risk 2: The funding sought is not spent.** This initiative seeks to ensure that the Commission is funded to be able to undertake one regulatory backstop process each year. This is important for establishing the credible threat of regulation that the regulatory backstop is intended to create. If wholesale fuel suppliers appropriately respond to this threat and are found to consistently set reasonable terminal gate prices, then it is possible the Commission will not need to invoke the backstop process (noting that the Minister could also require the Commission to invoke the backstop process at any time). In recognition of this risk, the Commission proposes not to draw down the full funding associated with the backstop regime unless the backstop process is initiated (subject to preserving a small contingency to mitigate Risk 1 above).
What are the key constraints?	The Bill will establish the key features of the regulatory backstop (and confer responsibility for administering the backstop on the Commission). For example, the Bill will establish requirements on: • the Commission to consult as part of its inquiries into whether regulation should be imposed and on the pricing methods and principles it proposes to set; • the test the Commission must apply in assessing whether regulation should be imposed; and • the information gathering and enforcement powers that will be available to the Commission in carrying out this function.
What are the key dependencies?	A key dependency is that the Fuel Industry Amendment Bill still needs to make its way through the House. (It is expected to pass and receive Royal Assent in July 2023 and take effect the day after Royal Assent.)

Section 4C: Governance and timeframes

What are the governance arrangements for this initiative?	Under the legislation, some key decisions in relation to the administration of the regulatory backstop will be vested in the Commission. These decisions-making responsibilities will be exercised by the Commission's Fuel Division, which is a subset of the members of the Commerce Commission (i.e. Commissioners). At a management level, the Commission's work in relation to the fuel regulatory backstop will be overseen by a governance group, comprising senior leaders and experts from within the Commission.

	The Commission will be required by legislation to consult interested parties in the course of carrying our inquiries into terminal gate prices and in setting regulated pricing principles or methods. Effective consultation is an important part of robust regulatory decision-making processes, and an area where the Commerce Commission holds itself to a high standard. As such, the Commission's administration of the regulatory process will have a strong focus on testing the Commission's analysis through consultation, which will be supported by the governance structures within the Commission (including oversight from lawyers and Commissioners).
Timeframes and monitoring	The Commission's quarterly reports on its fuel market monitoring will provide a regular touchpoint with Ministers, industry and the public. Through these reports, the Commission will be able to signal where it might have concerns about the level at which terminal gate prices are set. Where the Commission decides to invoke the regulatory backstop, these processes will be open to public consultation and so visible to the public and the Minister. As required by the legislation, the Minister will also receive recommendations from the Commission as a result of inquiries into whether particular terminal gate prices should be regulated. The Commission will also report on its use of the regulatory backstop through its formal accountability documents and regular updates to the Minister, as relevant.

Section 4D: Demonstrating performance

Significant initiative

This is a Government priority initiative, but it is not a 'significant initiative'.

Evaluation

This initiative will allow the Commission to monitor whether the terminal gate prices that wholesale fuel suppliers are setting are consistent with what would be expected in a competitive market. Where the Commission's analysis reveals concerns (or where directed by the Minister), the Commission could then conduct an inquiry into whether the terminal gate prices should be regulated. Through its monitoring and inquiries, the Commission will be able to evaluate whether the regulatory backstop, and the funding provided through this initiative, have delivered on their intent – i.e. to incentivise wholesale suppliers to set competitive terminal gate prices.

Where the Commission conducts an inquiry, the Minister imposes regulation, and the Commission then sets a regulated pricing method or principle, this initiative will allow the Commission to monitor the effectiveness of the regulated pricing method/principle on an ongoing basis. Where this evaluation finds that the regulated pricing method/principle could be improved, this initiative would allow the Commission to amend its price determination to improve its effectiveness (after consulting).

MBIE will also monitor the effectiveness of the Fuel Industry Act (including the regulatory backstop) as part of its regulatory stewardship role for the Energy Markets Regulatory System.

Estimates

This initiative will not result in new measures being added to the Commission's SPE. Because the regulatory backstop will only be invoked where necessary, it is not appropriate to set targets for how many times it will be invoked (or for associated outputs).

The Commission's SPE already includes measures relating to the production of competition monitoring reports under the Fuel Industry Act. Under this initiative, those reports are likely to include an increased focus on terminal gate prices, including signalling to industry where terminal gate prices might higher than would be expected in a competitive market. However, this initiative will not increase the number of those reports, so will not result in a change to the estimates.

Section 5: Initiatives with Distributional/System Impacts

Section 5A: Māori initiatives

The answer to each question must not exceed 2-3 paragraphs.

What kind of impact would the initiative have on Māori?	**A**	Direct impact	☐	This initiative may also have indirect positive impacts on Māori. This is because it will put downward pressure on fuel prices, and fuel costs make up a greater share of household expenditure for lower income households.
		Indirect impact	☒	
	B	Targeted and tailored impact	☐	As above.
		Disproportionate positive impact	☒	
		Other	☐	
	C	Click or tap here to enter text.		

	Kotahitanga	Tikanga	Whanaungatanga	Manaakitanga	Tiakitanga
How does the initiative align with any of the	☐	☐	☐	☐	☒

means of He Ara Waiora?	This initiative will align with the principle of Tiakitanga in that it will allow the Commission to provide guardianship/stewardship of a new regulatory function that it is responsible for administering. It also aligns with Tiakitanga in that it will help guard/promote competition in fuel markets for the benefit of New Zealand households and businesses.	
How will the initiative contribute to the ends of He Ara Waiora?	Te Taiao ☐ Te Ira Tangata ☒	This initiative will put downward pressure on fuel prices, which will benefit New Zealand households, businesses and the economy. Because fuel costs make up a greater share of household expenditure for lower income households, this initiative will have a disproportionately positive impact on lower income households

Section 5B: Pacific initiatives

The answer to each question must not exceed 2-3 paragraphs.

What kind of impact would the initiative have on Pacific people?	**A**	Direct impact	☐	This initiative may also have indirect positive impacts on Pacific Peoples. This is because it will put downward pressure on fuel prices, and fuel costs make up a greater share of household expenditure for lower income households.
		Indirect impact	☒	
	B	Targeted and tailored impact	☐	As above.
		Disproportionate positive impact	☒	
		Other	☐	
	C	*List any assumptions you have made in considering impacts for Pacific communities.*		

How would the initiative contribute to the focus areas of the All-of-Government Pacific Wellbeing Strategy?	**Lalaga Potu:** Cultural Values and Principles	☐	**Fale Fono**: Partnership and Governance	☐	**Vaka Moana**: Performance and Improvement	☐	**Te Kupega**: Capability	☐
	No obvious contribution to these focus areas.							
How would the initiative contribute to the outcomes for Pacific communities articulated in the Pacific Wellbeing Outcomes Framework?	**Goal 1**: Thriving Pacific languages, cultures, and identities	☐	**Goal 2:** Prosperous Pacific communities	☒	**Goal 3:** Resilient and healthy Pacific families	☒	**Goal 4:** Confident, resilient, and thriving Pacific young people	☒
	This initiative will put downward pressure on fuel prices, which will benefit New Zealand households, businesses and the economy. Because fuel costs make up a greater share of household expenditure for lower income households, this initiative will have a disproportionately positive impact on lower income households. This will make those households (and businesses) more resilient and prosperous.							

Section 5C: Child poverty initiatives

The answer to each question must not exceed 2-3 paragraphs.

What kind of impact would the initiative have on reducing child poverty?	**A**	Direct impact	☐	This initiative may also have indirect positive impacts on child poverty. This is because it will put downward pressure on fuel prices, and fuel costs make up a greater share of household expenditure for lower income households.
		Indirect impact	☒	
	B	Targeted and tailored impact	☐	As above.
		Disproportionate positive impact	☒	
		Other	☐	
Does the initiative align with the Child and Youth Wellbeing Strategy?	***Yes***	This initiative broadly aligns with the outcome 'Children and young people have what they need' in the Child and Youth Wellbeing strategy. This is because it will put downward pressure on fuel prices, which could be expected to reduce the share of household income spent on fuel, leaving more for things like food and housing.		

Section 5D: Initiatives with impacts on women and girls

Which group(s) of women and girls	Māori	☐	Pacific	☐	Asian	☐	Culturally and linguistically diverse	☐

would be impacted by the initiative? Select all that apply.	Older persons	☐	Younger persons	☐	Migrants	☐	Refugees	☐
	LGBTQIA+	☐	Rural persons and communities	☐	Students	☐	Disabled people and those with disabilities	☐
	Business owners	☐	Employees	☐	Specific industries or sectors	☐	Other	☐
	Click or tap here to enter text.							
How many women and girls would be affected by this initiative?	-							
Qualitative impacts: Refer to the guidance for examples.								
What is the initiative expected to achieve that will help to improve outcomes for women and girls, including for wāhine Māori and kōtiro?	-							
What direct and indirect impacts on women and girls is the initiative expected to have, including on wāhine Māori and kōtiro?	-							
Are there any anticipated negative impacts of the initiative on women and girls, including on wāhine Māori and kōtiro?	-							
Describe how the initiative contributes to the wellbeing objectives and improves outcomes for women and girls.	-							

Section 5E: Initiatives with environmental impacts

Does the initiative align to a category within the Green Bond Framework?	Clean Transport	☐	Energy Efficiency and Renewable Energy	☐	Living and Natural Resources and Land Use	☐	Terrestrial and Aquatic Biodiversity	☐
	Climate Change Adaptation	☐	Sustainable Water and Wastewater Management	☐	Pollution Prevention and Control	☐	Green Buildings	☐
	NA							

<table>
<tr><td rowspan="6">Does the initiative have significant direct or indirect environmental impacts (positive or negative) beyond any climate change implications caught by CERF?</td><td rowspan="2">A</td><td>Direct impacts</td><td>☐</td><td rowspan="2">This initiative may have minor indirect negative impacts on the environment. However, because fuel is a relatively inelastic good, any reduction in fuel margins (and therefore prices) as a result of the Commerce Commission's work is unlikely to have any appreciable impact on emissions. Further, fuel is part of the emissions trading scheme, so there should be no impact on net emissions.</td></tr>
<tr><td>Indirect impacts</td><td>☒</td></tr>
<tr><td rowspan="2">B</td><td>Avert long-term tipping-points</td><td>☐</td><td rowspan="2">Explain how the impact of the initiative relates to environmental tipping-points.</td></tr>
<tr><td>Advance long-term tipping-points</td><td>☐</td></tr>
<tr><td>C</td><td colspan="3">Fuel is an inelastic good, so small reductions in price are unlikely to significantly affect consumption (and therefore emissions) levels. (On the low price elasticity of fuel, see D Kennedy and I Wallis "Impacts of fuel price changes on New Zealand transport" (Land Transport New Zealand Research Report, 2007; and the ComCom Market Study, paras 2.21-2.22).
Because fuel is part of the emissions trading scheme, any reduction in fuel prices should have no impact on net emissions.</td></tr>
</table>

Section 5F: Regulatory systems initiatives

The answer to each question must not exceed 2-3 paragraphs.

<table>
<tr><td>Which regulatory system(s) does the initiative relate to?</td><td colspan="8">Energy markets regulatory system</td></tr>
<tr><td rowspan="2">Which category does the initiative primarily relate to?</td><td>A major government reform priority (e.g. manifesto commitments)</td><td>☐</td><td>Managing or mitigating operational performance of risks</td><td>☐</td><td>Enabling economic activity and/or easing compliance burdens</td><td>☒</td><td>Other</td><td>☐</td></tr>
<tr><td colspan="8">If other, describe here.</td></tr>
<tr><td>Which stage of the policy or legislative process is the proposal at?</td><td colspan="8">Policy decisions have been taken by Cabinet on the regulatory backstop (DEV-22-MIN-0170 refers) and the Fuel Industry Amendment Bill is currently before the house. It is expected to take effect in July 2023.</td></tr>
</table>

Attachment: More detailed information about the problem definition

Purpose: this attachment expands on 'Section 2A: Problem definition', to provide important further context for this initiative.

In 2019, the Commerce Commission concluded a fuel market study. The market study found a number of shortcomings in the competitiveness of fuel markets in New Zealand, including wholesale prices that were higher than would be expected in a competitive market – which flows through to consumers paying higher pump prices. Following the market study, the Government introduced the Fuel Industry Act 2020 (the Act). The Act sets up a regulatory regime for fuel with the purpose of promoting competition in engine fuel markets for the long-term benefit of consumers. One of the interventions introduced by the Act was a wholesale pricing regime, known as 'terminal gate pricing', which aims to promote competition by requiring wholesale fuel suppliers to offer a spot price at which they will sell fuel to wholesale customers at storage terminals.

However, as noted by the Commerce Commission in its market study, there are risks to the success of the terminal gate pricing regime. Wholesale suppliers could use it as a vehicle for price co-ordination or could set terminal gate prices that reflect their market power, particularly at isolated terminals. Accordingly, the Commerce Commission recommended that the introduction of a terminal gate price regime should be accompanied by a regulatory backstop to incentivise wholesale suppliers to offer competitive terminal gate prices by creating a credible threat of further regulation if they do not.

A regulatory backstop was not included in the Act at the time it was passed in 2020 due to the significant design requirements. Instead, the Government agreed to defer the implementation of a backstop regime and asked officials to develop a regulatory backstop to be implemented at a future point. MBIE recommenced work on designing the regulatory backstop in 2022, and in August 2022 Cabinet made policy decisions on the design of the regulatory backstop. The Fuel Industry Amendment Bill was introduced to the House in November 2022 to give effect to those decisions.

In agreeing policy decisions to inform the Fuel Industry Amendment Bill in August 2022, the Cabinet Economic Development Committee agreed that new ongoing funding is required for the Commerce Commission implement the regulatory backstop, to be sought as part of Budget 2023 (DEV-22-MIN-0170 refers).

Under the Bill, the Commerce Commission will be responsible for administering the regulatory backstop. This will include:

- analysing terminal gate prices to determine when to undertake an inquiry;
- undertaking inquiries to inform recommendations to the Minister on whether certain terminal gate prices should be regulated; and
- setting regulated pricing methodologies for any terminals that the Minister declares as regulated.

This is a new function that is not currently funded. The Commerce Commission's responsibility for this function is expected to commence in July 2023

Note: Funding was provided in Budget 2021 for the Commission's other roles under the Fuel Industry Act. However, at that time, funding was not sought for a regulatory backstop. The Budget 2021 Bid noted that:

> "The Government has indicated it may consider whether to introduce a regulatory backstop, which would likely require an amendment to the Fuel Industry Act. Due to uncertainty about the timing and nature of any regulatory backstop, the costs of the Commission's involvement with the introduction of a regulatory backstop are not included in this funding proposal."

There are two key risks if this initiative does not receive funding in Budget 2023:

1. **The regulatory backstop may not achieve its intent.** The introduction of a regulatory backstop is intended to provide a clear pathway for terminal gate prices to be regulated where they are higher than would be expected in a workably competitive market. As such, the presence of a backstop in the legislation is intended to incentivise wholesale suppliers not to set excessive terminal gate prices. This incentive will only exist if the backstop is perceived as a credible threat that further regulation will be imposed where terminal gate prices are excessive. In order for the regulatory backstop to be credible, it must be properly funded. The Commerce Commission needs to be funded to undertake at least one backstop process per year if the backstop is to be perceived by wholesale suppliers as a credible threat of further regulation.

2. **The Fuel Industry Act may not achieve its intent.** If funding is not provided for administering the regulatory backstop, then the Commerce Commission will need to spread its existing Fuel Industry Act funding across a broader set of functions (i.e. its existing market monitoring and compliance & enforcement functions, plus the backstop function). This may undermine the Commerce Commission's ability to properly deliver on its powers, duties and functions under the Fuel Industry Act and its ability to achieve the purpose of the Act, which is to promote competition in fuel markets for the long-term benefit of fuel users.