



22 March 2019

Miriam Dean QC
Chair
Expert Advisory Panel
Electricity Price Review
c/- Ministry of Business, Innovation & Employment
by email to energymarkets@mbie.govt.nz

Dear Miriam

Electricity Price Review options

Please find attached feedback on the 41-options in the Expert Advisory Panel's Electricity Price Review Options Paper of 18 February 2019.¹

MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

In preparing this feedback we have benefited from the opportunity to discuss the options directly with you and panel members and to participate in the cross-sector workshops. The workshops have influenced our thinking on and support for the use of trials and pilot processes and for market participants, including MEUG, to take ownership and find solutions to challenges in the sector rather than wait for government intervention.

Attached and to be considered part of this submission on options F6 and D1 is a report by TDB Advisory titled Gas Sector Governance Interim report, 21 March 2019.

Yours sincerely

A handwritten signature in black ink, appearing to read "R. Matthes", with a long horizontal stroke extending to the right.

Ralph Matthes
Executive Director

¹ <https://www.mbie.govt.nz/dmsdocument/4578-electricity-price-review-options-paper>

A1	<p>Establish a consumer advisory council</p> <p>MEUG supports establishment of a pilot council using existing Commerce Commission and Electricity Authority resources. From the workshops we understand this is a pragmatic route to trial what a council would work on, how it's members would be appointed and what final form it might take.</p> <p>The function and form of the council in the longer-term will determine the appropriate levels of and means for resourcing the council. An important design question is whether the voice of consumers requires strengthening across all utilities when regulatory policy decisions are being considered by the Commerce Commission, the Electricity Authority and the Gas Industry Company for electricity, gas, fibre and potentially water?</p> <p>The options paper states, "The Council could be funded by a levy on electricity industry participants ..." and recognises that "... levy funding would require legislation." The latter will take time not just to amend the legislation but to then conduct consultation on the design and rate of a levy. MEUG does not expect that process could be completed before mid-next year at a minimum. Hence our support for the offer by the Commerce Commission and Electricity Authority to trial a consumer advisory council using their resources. We welcomed the acknowledgement at the workshops by the regulators that the consumer advisory council and any interim trial must be, and be seen to be, independent of the regulators.</p> <p>MEUG suggests it is premature for the options paper to have proposed a consumer advisory council be funded by a levy when the function and form of the council is yet to be determined.</p> <p>Similarly, MEUG is concerned the option paper proposed to use a tax, i.e. levy, on all or some electricity participants for options B1, B2, B5, D2 and G1 without considering which participants will pay the tax, the ultimate incidence on end consumers and the alignment or misalignment (i.e. cross-subsidy) of those benefitting from programmes funded by the tax with those that pay the tax.</p>
A2	<p>Ensure regulators listen to consumers</p> <p>This is a given. The question is whether the regulators are listening? If regulators are listening to consumers, then the regulators will have a view on what price-quality and other dimensions of economic utility are important to individual or similar classes of consumers and therefore be able to explain how those might change with proposed regulatory changes. An example of where this might not be the case follows.</p> <p>Meridian Energy have succinctly put the argument that the Commerce Commission in consultation on issues for the current reset of the Default Price-quality Path for non-exempt Electricity Distribution Service providers (DPP3 reset) and Transpower's Individual Price-Quality Path (IPP 2020 reset) need to demonstrate the proposed effect on consumers aligns with outcomes occurring in competitive markets.² MEUG agrees with Meridian that it is not clear that this is the Commission's measure of success for the DPP3 reset and IPP 2020 reset.</p>

² For example, see Meridian Energy submission to the Commerce Commission, Transpower IPP 2020 – Issues paper, 28 February 2019.

Refer https://comcom.govt.nz/_data/assets/pdf_file/0020/127244/Meridian-Submission-on-Transpowers-IPP-reset-issues-paper-28-February-2019.pdf.

B1	<p>Establish a cross-sector energy hardship group</p> <p>Agree worth considering. Non-Governmental Organisations (NGO's) and retailers have noted they already have extensive and intensive engagement with a range of government organisations that use valuable NGO and retailer resources. Hence there needs to be clarity on what gap in the current engagement matrix the proposed cross-sector energy hardship group is intended to fill and a clear articulation of the incremental benefits and costs to NGO's, retailers and their constituents of this new group.</p> <p>In addition to understanding how the proposed cross-sector energy hardship group will add value to the existing myriad engagement processes with government agencies, consideration is needed on how the work of the group will align with:</p> <ul style="list-style-type: none"> • The work of the proposed consumer advisory council; and • Governments work, being managed by the Treasury and Statistics NZ, to develop a range of metrics for measuring well-being to complement existing economic measures of consumer welfare.
B2	<p>Define energy hardship</p> <p>Agree. MEUG assumes this option will also define consumers that are vulnerable and are medically dependent discussed later in option B6. Option B2 should be a priority because it is a necessary precursor before detailed plans for implementing options B1, B3, B4, B5 and B6 can commence. MEUG would like to be consulted on any work on this option because this is not a trivial exercise, is fundamental to any optimal and successful execution of work programmes reduce energy hardship and requires integration with the government's well-being work programmes.</p> <p>We welcome the helpful contribution by the Electricity Retailers Association of NZ (ERANZ) in commissioning the report by PwC, Definition of Energy Vulnerability in NZ, November 2018.</p> <p>MEUG considers any definition of energy hardship must align with the Governments work, being managed by the Treasury and Statistics NZ, to develop a range of metrics for measuring well-being to complement existing economic measures of consumer welfare.</p> <p>Ensuring work on defining energy hardship is undertaken in the context of the broader well-being reporting and policy development framework is a reminder that care needs to be taken to mitigate unintended consequences. For example, shifting costs where there is no long-term economic efficiency benefit or adding costs (such as new levies discussed in feedback on options 1) to businesses purportedly to help households in hardship. In that a case, businesses in aggregate and over-time will be less competitive because of the higher costs and taxes potentially leading to reduced employment and wages of the very households the options paper is most concerned with.</p>
B3	<p>Establish a network of community-level support services to help consumers in energy hardship</p> <p>Same feedback as option B1 above.</p>
B4	<p>Set up a fund to help households in energy hardship become more energy efficient</p> <p>First step is to complete option B2 Define energy hardship. Then decide what interventions are needed for households that are defined as having energy hardship.</p>

B5	Offer extra financial support for households in energy hardship
	Same feedback as option B4 above.

B6	Set mandatory minimum standards to protect vulnerable and medically dependent consumers
	It's unclear if the reported breaches of the voluntary standards were one-off events and remedial action has been taken to mitigate repeat events, or there is a systemic problem. If the latter, then mandatory standards may be the best solution as a last resort. MEUG notes the observation by retailers at the workshops that they are not well placed to determine the vulnerability and hardship status of consumers and the reliance on customers self-declaring their status. If true, then setting minimum standards will not alleviate the problem. Other solutions are needed such as government agencies and NGOs's using an agreed measure of energy hardship, using that to identify households and relaying that information to retailers.

B7	Prohibit prompt payment discounts but allow reasonable late payment fees
	<p>This is a complex issue. The threshold for prohibiting an action is, necessarily, very high and needs to be clearly in the long-term interests of consumers. Prohibiting behaviours that do not meet the high threshold invites lobbying for prohibition of similarly weakly justified interventions. This is a slippery slope that will undermine confidence in the independence and or quality of decision making by the regulator.</p> <p>The jurisdictions of the Electricity Authority and the Commerce Commission (Part 2 of the Commerce Act) intersect on this issue. Those agencies should decide on the merits of this option. The Commission and Authority we understand are and should continue to consider feedback from the Electricity Price Review expert panel, submitters to the panel and analysis and precedents from overseas regulators.</p>

B8	Explore bulk deals for social housing and/or Work and Income clients
	Housing NZ explained at the workshops that they and other government agencies have been considering this for some time. It's complex. Any insights the Electricity Price Review Expert Panel might give to Housing NZ and other agencies to resolve the complexities of implementation would be welcome.

C	INCREASING RETAIL COMPETITION
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C1	Make it easier for consumers to shop around
	Worth considering further. MEUG agrees with the EPR panel view to not favour the variation to the primary option that retailers must disclose all “generally available” price offers.
C2	Include information on power bills to help consumers switch retailer or resolve billing disputes
	<p>Worth considering further by the Electricity Authority. MEUG does not support an intervention that removed the option for those consumers that preferred to forego having detailed cost breakdowns on their invoice in order to have a low-cost retail service.</p> <p>At the workshops the impression gained was that all parties recognise there is a problem with ensuring consumers know that the dispute resolution service of Utilities Disputes Ltd (UDL) is available given most consumers receive invoices electronically and therefore requiring references to UDL on those is ineffective. Perhaps it’s time to reconsider if we should have a utilities Ombudsman because the public recognition of the Ombudsman brand for the Banking Ombudsman and the Insurance and Financial Services Ombudsman, anecdotally, appears to be higher than for UDL.</p>
C3	Make it easier to access electricity usage data
	MEUG supports the Electricity Authority’s current work on this option. Findings from the Electricity Price Review should be relayed to the Authority to assist their implementation of this option.
C4	Make distributors offer retailers standard terms for network access
	MEUG supports the Electricity Authority’s current work on this option. Findings from the Electricity Price Review should be relayed to the Authority to assist their implementation of this option.
C5	Prohibit win-backs
	MEUG supports the Electricity Authority’s current work on this option. Findings from the Electricity Price Review should be relayed to the Authority to assist their implementation of this option.
C6	Help non-switching consumers find better deals
	Worth considering further.
C7	Introduce retail price caps
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.

D1	Toughen rules on disclosing wholesale market information
	<p>MEUG supports the Electricity Authority’s current work on this option. Findings from the Electricity Price Review should be relayed to the Authority to assist their implementation of this option.</p> <p>Options D1 and D2 encompass improvement to information flows (D1) and liquidity in hedges when the market is stressed (D2). There is a third aspect to the wholesale market not considered in the options paper; namely improving how real-time spot prices are discovered. MEUG suggests that issue should be an additional option in the Electricity Price Review’s report to the Minister. The Electricity Authority has in the past focused on improving how real-time spot prices are discovered because the closer those are to true efficient spot prices then the more efficient real-time demand response and efficient hedge markets will develop. Currently the focus of that work is implementation of Real-Time-Pricing (RTP). MEUG agrees with the Electricity Authority’s ranking of implementing RTP as one of the six top priority projects for 2018/19.³ However RTP will not be in place for several years and hence there is a gap whereby discovery of real-time prices can, when the market is stressed, potentially be poorly aligned with true efficient spot prices. MEUG suggests this is a sufficiently material issue that it should be ranked as a high priority topic equivalent to hedge liquidity (option D2) and information disclosure (option D1).</p> <p>In feedback on option F6 establish an electricity and gas regulator we mention the current work by TDB Advisory for MEUG on, amongst other things, potential key policy and operational issues common to the gas and electricity sectors. The discussion in F6 is also relevant to option D1 in relation to gas sector operating information critical to the electricity sector security of supply.</p>
D2	Introduce mandatory market-making obligations
	<p>There are many ways market making could be designed. MEUG supports initiatives by market participants to find an optimal solution. In parallel and as a back-stop MEUG also supports the Electricity Authority’s current work on considering alternative incentive-based (to discover lowest cost providers) market-making options. Findings from the Electricity Price Review should be relayed to the Authority to assist their consideration of alternatives.</p>

³ The Electricity Authority’s top priority projects are RTP, equal access, multiple trading relationships, transmission pricing methodology, distribution pricing principles, and extended reserves.

D3	Make generator-retailers release information about the profitability of their retailing activities
	<p>MEUG is not convinced this solution is the best approach if the policy issue is to determine if large vertically integrated suppliers have been earning persistent excess economic profits over time and therefore potentially signalling a systemic policy problem in the relative market power of large vertically integrated suppliers compared to other suppliers and in the industry.</p> <p>If segmented financial information (audited income and financial statements) as proposed or inferred by this option were available, it would allow full accounting and economic analysis to be undertaken. MEUG and others have submitted to the concurrent Commerce Commission Retail Fuel Market Study, as well as the earlier Electricity Price Review issues paper, that margin and ratio analysis are partial and incomplete tools and unlikely to answer the question of whether large vertically integrated suppliers have been earning excess economic profits over time?</p> <p>The recent independent submission by Ireland, Wallace & Associates (IWA) on the Retail Fuel Market Study set out how a conventional regulatory economic model using audited financial information can assess historic economic profits.⁴ In that analysis the performance of the industry and the three major fuel suppliers that dominate it were analysed for up to 10 years. It identified a substantial change in the industry after 2015 whereby material excess economic profits have been realised.</p> <p>This conventional regulatory economic model using audited financial information could be routinely conducted by the Electricity Authority to determine if there is a systemic market problem and hence if remedial action is needed. An advantage of this approach is it does not require new disclosure requirements for suppliers and can be implemented quickly. MEUG suggests the Authority scope a possible trial to assess economic profits with a conventional regulatory economic model using audited financial information. We are open to discussing with the Authority undertaking such a trial on a co-funded basis.</p>

D4	Monitor contract prices and generation costs more closely
	<p>Consistent with the feedback on option D3 above, this is an inferior tool and may lead to mis-information compared to assessing of there are persistent excess profits being earned by means of a conventional regulatory economic model using audited financial information.</p> <p>MBIE should resume the routine publication of future energy scenario's using updated estimates of the long-run and short-run costs of existing and potentially new generation and storage devices. Given some forecasters predict the speed of changing economics and adoption of new technologies is likely to accelerate, MBIE should consider updating their energy scenarios every 2-years. The Electricity Authority we see as a source of information for MBIE updating their models and a user of MBIE's models rather than the primary owner and responsible agent for estimating and publishing long-run and short-run supply and storage costs.</p>

D5	Prohibit vertically integrated companies
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.

⁴ IWA, Market study into the retail fuel sector: Invitation to comment on preliminary issues, Commerce Commission NZ, A submission on Question 9: "Trends in Profits", 21 February 2019, refer https://comcom.govt.nz/_data/assets/pdf_file/0015/127302/Ireland.-Wallace-and-Associates-Submission-on-preliminary-issues-paper-21-February-2019.pdf

E IMPROVING TRANSMISSION AND DISTRIBUTION

E1	Issue a government policy statement on transmission pricing
	<p>MEUG does not favour this option.</p> <p>The government can at any-time issue a government policy statement (GPS). We do not support the rationale in the Issues Paper that a GPS will solve detailed contentious issues. Quite the reverse we see a GPS that goes beyond outlining principles will simply move the debate and intensify lobbying to the political level and thereby delay further the current review of the Transmission Pricing Methodology guidelines (TPM review). The draft GPS proposed by Transpower reinforces our view that parties will attempt to capture the detail they seek from the TPM review in the detail of the GPS. If the Electricity Price Review Expert Panel retains the view in the final report to the Minister that a GPS is necessary that will, in our view, reopen the door to other parties seeking detailed GPS interventions for their pet topics. A GPS for the TPM review that has weak rationale for being implemented will increase the risk of a slippery slope where we revert to the problem with the Electricity Commission where detailed and often contradictory GPS were given to the then Commission.</p> <p>The Electricity Authority has announced a discussion paper on the TPM review is imminent. Irrespective of the recommendations of the Electricity Price Review Expert Panel, we would expect that when MBIE are giving advice to the Minister on that paper they would routinely consider options the Minister has including the pros and cons at that point of issuing a GPS.</p>

E2	Issue a government policy statement on distribution pricing
	MEUG does not favour this option for the same reasons set out for opposing option E1 above.

E3	Regulate distribution cost allocation principles
	<p>MEUG does not favour this option for the same reasons set out for opposing option E1 and E2 above because the same arguments that apply to the Minister deciding on and publishing a GPS also apply to the Minister deciding on and intervening with new regulations.</p> <p>For option B2 Define Energy hardship above, MEUG noted, "... care needs to be taken to mitigate unintended consequences. For example, shifting costs where there is no long-term economic efficiency benefit or adding costs (such as new levies discussed in feedback on options 1) to businesses purportedly to help households in hardship. In that a case, businesses in aggregate and over-time will be less competitive because of the higher costs and taxes potentially leading to reduced employment and wages of the very households the options paper is most concerned with." The same applies to option E3.</p> <p>The options paper noted "... some submitters acknowledged merit in a review of how to allocate costs between residential and non-residential consumers. We are keen to explore whether this can be achieved in some other way than potentially heavy-handed regulation." MEUG agrees with the latter recognition that regulation should be considered a last resort. MEUG does not believe there is a significant gap in the regulatory processes between the Commerce Commission, Electricity Authority and industry led initiatives to improve distribution pricing including the treatment of allocating common costs. No new process is required apart from, as a result of the earlier issues paper, a recognition that the treatment of common costs needs to be part of the detailed and interlinked work needed on ensuring all costs are efficient, cost allocation methodologies align with costs and line tariff designs reflect costs as well as value for service in terms discrete consumer segments choice of price-quality trade-offs.</p>

E4	Limit price shocks from distribution price increases
	MEUG does not favour this option.
E5	Phase out low fixed charge tariff regulations
	MEUG is not convinced there are direct benefits that will be attributable to removing the regulations that will exceed the costs to government and the sector of repealing the regulations.
E6	Ensure access to smart meter data on reasonable terms
	MEUG supports the Electricity Authority's current work on this option. Findings from the Electricity Price Review should be relayed to the Authority to assist their implementation of this option.
E7	Strengthen the Commerce Commission's powers to regulate distributors' performance
	Worth considering further.
E8	Require small distributors to amalgamate
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.
E9	Lower Transpower and distributors' asset values and rates of return
	<p>The phrasing of this option could be misconstrued. Depending on how the option is read MEUG submits:</p> <ul style="list-style-type: none"> • MEUG in various regulatory processes under the remit of the Commerce Commission and the Electricity Authority MEUG has submitted, and we continue to submit, that the regulated cost of capital is excessive given the risks the monopolies bear. Neither have we conceded the argument that there may be an economic benefit, particularly for Transpower, that some sunk asset costs be written off at the cost of Transpower's owner, the government, because they are over-built and under-utilised. On this basis we agree with the option. • If the option were re-phrased "lower Transpower and distributors' asset values and rates of return by resetting asset values to historic costs" then MEUG would not support resetting asset values to historic costs but would continue to argue regulated rates of return are excessive.

F IMPROVING THE REGULATORY SYSTEM

F1	Give the EA clearer, more flexible powers to regulate network access for distributed energy services
	Worth considering further.

F2	Transfer the EA's transmission and distribution-related regulatory functions to the CC
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.

F3	Give regulators environmental and fairness goals
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.

F4	Allow Electricity Authority decisions to be appealed on their merits
	MEUG agrees with the Electricity Price Review Expert Panel that this option is not favoured.

F5	Update the EA's compliance framework and strengthen its information-gathering powers
	Worth considering further.

F6	Establish an electricity and gas regulator
	To assist MEUG identify what are the strategic and operational issues between the gas and electricity sectors MEUG has commissioned TDB Advisory to undertake a high-level assessment of potential key policy and operational issues common to the gas and electricity sectors and the advantages and disadvantages of alternative institutional arrangements for governing the gas sector, including the option of establishing a joint gas and electricity regulator, as raised by the EPR. The assessment is relevant to this option F6 and D1, Toughen rules on disclosing wholesale market information. The interim findings of TDB Advisory are attached in a separate report for the information of the Expert Panel. The interim report is public. A final report will be available at the end of April. MEUG welcomes the collaborative assistance of MBIE, the Gas Industry Company, parties in the gas supply chain, users of gas including electricity generators. The Major Gas User's Group, the System Operator, the Electricity Authority and the Commerce Commission are also assisting the assessment by TDB Advisory.

G PREPARING FOR A LOW-CARBON FUTURE

G1	Set up a fund to encourage more innovation
	MEUG does not favour this option as it is a matter under consideration by the Commerce Commission in the DPP3 reset.

G2	Examine security and resilience of electricity supply
	<p>MEUG supports the Commerce Commission and Electricity Authority’s current workstreams that encompass having and continuously improving policies on security and resilience.⁵ In the future we expect other agencies will also include in their publication’s commentary an advice on security and resilience such as:</p> <ul style="list-style-type: none"> • MBIE should they resume regular publications of energy scenarios. We think they should, as discussed in option D4. • The work of the future Climate Change Commission and the imminent report of the Interim Climate Change Committee. <p>Therefore, we see no obvious critical gap in current and future government agency and regulatory oversight of security and resilience.</p>

G3	Encourage more co-ordination among agencies
	At the workshops it was clear there was good co-ordination by Housing NZ with other departments, Crown entities, regulators, NGO’s and retailers. MEUG supports the pro-active co-ordination that is already happening.

G4	Improve the energy efficiency of new and existing buildings
	This is already happening with the new healthy homes standards to make rental properties warmer and drier announced by Hon Phil Twyford on 24 th February 2019.

⁵ The work of the Authority in relation to security and resilience is partly contracted to the System Operator.

Gas Sector Governance Interim Report



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Gas Sector Governance Interim Report

Background

Natural gas generates **14% of New Zealand's electricity and 22% of its energy** and is a major input into petrochemicals and industrial processes. The gas industry operates under a **co-regulatory model**. **The Gas Industry Company Limited (GIC) is the 'industry body'** under Part 4A of the Gas Act 1992 (Gas Act). The GIC is currently responsible for seeking voluntary resolution to problems affecting gas processing, pipelines, wholesale and retail functions. GIC can recommend full regulation where voluntary solutions cannot be found.

In September 2018, a faulty valve curtailed production from offshore wells in the Pohokura gas field for three months. **It was Pohokura's second outage in 2018. While the first outage** passed without incident, the second coincided with low hydro levels, outages in other fields, and high competing demand for gas from petrochemicals and agriculture. In combination, these factors led to a large, sustained and unprecedented rise in the wholesale electricity price, with serious consequences for exposed households and businesses.

Outages at Pohokura have raised questions about disclosure and governance in the gas industry. In a letter to GIC in July 2018, the Minister for Energy and Resources asked the GIC to report on whether disclosure requirements are adequate.¹ The Electricity Price Review's (EPR) options paper released on 18 February favoured preliminary exploration of establishing a joint electricity and gas regulator and strengthening disclosure rules.

What we were asked to do

The Major Electricity Users Group (MEUG) asked TDB Advisory Ltd (TDB) to conduct a high-level assessment of alternative institutional arrangements for governing the gas sector. We have been asked to identify and consider issues in the current governance regime, in particular disclosure requirements, of the gas sector and the advantages and disadvantages of including the option of establishing a joint gas and electricity regulator. This interim report presents our findings from stakeholder engagements and desktop research to support MEUG's submission on the EPR's options paper. Our final report is due by the end of April.

What we did

Between 27 February and 15 March, TDB interviewed 22 gas industry stakeholders including upstream and downstream firms, experts, and regulators. Interviews were mostly conducted under Chatham House rules. We reviewed legislation, past gas-sector reviews, the Electricity Authority's 28 February Undesirable Trading Situation (UTS) decision, and documents from the GIC. We take other policy settings as given.

¹ Letter to GIC by Hon Megan Woods, 25 July 2018. Available from: <https://www.gasindustry.co.nz/dmsdocument/6412>

Initial findings

Information disclosure

Our engagement suggests information disclosure is the primary concern of stakeholders. There is strong and widespread dissatisfaction about the distribution and quality of information through the Pohokura outage. Stakeholders told us limited information significantly affected their planning and execution of their responses to the Pohokura outage. Considerable effort was diverted to finding information. We were advised of one (alleged) instance of a substantial financial transaction that would not have occurred but for better disclosure. There is a wide expectation that disclosure rules should be strengthened. We did not encounter express disagreement with this view.

Factors identified as preventing better information sharing included: internal company practices; rules in contracts against information sharing; the underlying uncertainty of the problem and resolution; and the higher concentration of New Zealand gas supply compared with other countries.

Information asymmetry is not limited only to the release of information into the public domain. It also includes quality of information (accuracy, substance); timeliness; certainty of disclosure (if there is new information stakeholders are made aware²); consistency (different stakeholders have the same facts); and availability (“one source of truth” to reduce search).

A small number of respondents alleged “gaming” i.e. deliberate withholding of information for financial advantage. This claim was investigated by the EA in its UTS decision and rejected. It is widely believed some market participants traded on information available to them. Several respondents said they had investigated whether a breach of law had occurred but none reported finding any. EA and ASIC investigations are ongoing, and we have not uncovered any concerns about the integrity of those processes.

Despite concerns around disclosure, a number of stakeholders indicated that business costs from the Pohokura event arose primarily from the disruption to gas supply, rather than inadequate disclosure. It is likely that wholesale electricity prices primarily reflected gas scarcity rather than information asymmetry. Although instances of opportunistic behaviour³ are alleged to have occurred, it is not clear these instances *depended* on information asymmetry, although that is possible. Several sources suggested more information was in the public domain than some stakeholders realised. Regardless, if concerns about information asymmetry and resulting uncertainty carry the potential to reduce confidence in the gas sector or the wider energy sector then increased disclosure may have benefits.

Our preliminary view is support for the introduction of disclosure rules for planned and unplanned outages of upstream gas production. Disclosure rules for commercial information could carry greater risks of unintended consequences. It is not clear what problem commercial disclosure might solve.

² Stakeholders also noted the value of being made aware when there is not new information.

³ The opportunistic behaviour we refer to here is the allegedly creative use of contractual terms between gas suppliers and purchasers. We are not referring to changes in energy portfolios through market trading, discussed in the EA’s UTS decision.

Security of supply

Given gas supply was the underlying issue, we were surprised at the limited concerns over reliability of supply. Pohokura had been reliable until 2018. Reliability declines as fields age. We saw no evidence New Zealand is unusual in reliability. Consultation revealed the mechanisms that support technical reliability including the financial cost of outages for well owners; checks conducted by insurers; downstream buyers may commission expert evaluations of equipment and procedures during contract negotiations; and the threat of **legal action by a field's owners** against its operator.

Co-regulation model

The Gas Act establishes the co-regulation model. The GIC is owned by fourteen companies **in the gas sector from upstream and downstream, each holding one \$1 share. GIC's board** has three industry directors and four independent directors. The Chair must be independent (GIC constitution 21.2). Co-regulation is based on voluntary compliance with industry-developed solutions under the threat of full regulation. Under the Gas Act model, GIC may recommend a regulated solution but must first exhaust options for voluntary solutions. The Act puts strong consultation obligations on GIC.

Views varied considerably on whether co-regulation is fit for purpose. A significant number of respondents believe the GIC is too close to industry, or captured, and is reactive rather than proactive. These concerns were connected to the prolonged transmission access negotiations prior to 2016, pipeline risk management, and curtailment rules setting by the Critical Contingency Operator (CCO). A small number of stakeholders have strong objections to the co-regulation model.

An initial review of the literature confirms industry capture as an inherent risk of self-regulation. However, the literature also identifies countervailing protections against **capture including the regulator's desire to be seen as competent by government and industry. Some stakeholders noted that GIC's board is careful to signal its independence**, for example by having only independent directors vote on major decisions (e.g. the Gas Transmission Access Code, or GTAC).

GIC has incentive to maintain the confidence of the Minister for Energy and Resources. The Gas Act provides that the Minister may **replace the GIC with an "Energy Commission"**, which is the Electricity Authority in the Act (s43ZZH(2)). In effect, the GIC serves at the will of the Minister. This is a potential counterweight to capture risks.

We heard roughly divided views on whether disclosure is likely to present a sterner test for GIC and the co-regulation model than GTAC. Disclosure may differ from GTAC in an important way. GTAC set access rules to a natural monopoly asset (pipelines), and the presence of that asset introduces an element of compulsion. Provided GTAC has legitimacy then the pipeline owner is in a position to decline access to anyone who disagrees with the **GTAC's terms**. Disclosure, on the other hand, is purely voluntary. In its disclosure options paper, GIC notes at least one industry participant has said it will not cooperate with voluntary disclosure.

GIC performance

GIC is seen generally as competent by those we spoke with. The recently-completed GTAC process is widely, though not universally, regarded as well-executed. **GIC's approach of consulting extensively and publishing all submissions** is widely supported. However, a

small number of stakeholders are very critical of the GIC's performance. Despite their frustration, these stakeholders spoke highly of the GIC staff's expertise, and one spoke of a recent performance improvement.

Each of the following issues were raised by a number of stakeholders. A number were uncomfortable with the industry-led approach in GTAC, seeing it as **the regulator's role to lead**. GIC revealed its position on GTAC late on the process, according to some **stakeholders, so "everyone was in the dark"**.

Some stakeholders asked whether GIC is sufficiently proactive – it is not clear, for example, whether information disclosure issues in the first Pohokura event might have **justified a proactive response by GIC in advance of the Minister's July request**. A small number of stakeholders also had concerns about whether GIC has been sufficiently **reactive, citing GIC's alleged** reluctance to look further at pipeline risks and CCO curtailment rules noted above.

Regarding compliance with existing rules, we did not hear **concerns about GIC's** enforcement.

Wholesale market performance during Pohokura

We asked stakeholders about the performance of wholesale market, including bilateral and spot market trades, during the second Pohokura outage. Separate to the question of information sharing is whether scarce gas ultimately found its way to its highest value use. A notable aspect of the second Pohokura outage was a loss of market liquidity throughout the event. Consultation revealed significant off-market (bilateral) trading of gas rights. Although some downstream users paid a high price for gas, we did not find evidence or hear suggestions that scarce gas supplies failed to find their highest value use during the Pohokura event. Furthermore, other than information asymmetry, we did not find any constraints on secondary trading of gas rights. Our interim view is that the wholesale gas market including bilateral trading performed well though the second Pohokura outage.

On the merits of a joint regulator

On the joint electricity-gas option, the EPR report of 18 February said it could **"develop and enforce regulations for both industries in a more consistent and coherent way, which would reduce uncertainty for regulated businesses. Economies of scale are likely to result in lower total costs."**

Our consultation did not reveal coordination of gas and electricity sector regulation as a concern. Gas information disclosure rules are below expectations. The primary consistency issue, uneven access to information, sits within the gas sector. There is a level of cooperation between EA and the GIC currently.

Consultation revealed only limited support for a joint electricity-gas regulator, or an energy sector-wide regulator. Many stakeholders could not see what problem is solved by a joint regulator. The weight of opinion we heard in consultation is that the sectors are quite different in most respects. One stakeholder suggested the cooperation that is occurring now between the two regulators may be exploiting some of the benefits of forming a joint regulator. A number of stakeholders were concerned that gas, the smaller of the two sectors, could be disregarded under joint regulator.

The factors cited by some stakeholders in support of a joint regulator included: the co-regulation model is vulnerable to gridlock; full regulation may bring greater independence, **a more proactive approach and "more teeth"**; there may be performance benefits from **achieving "critical mass"**.

Overall though, at this stage we have not been able to identify a strong case for a joint regulator. A benefit of self-regulation (including co-regulation) is low costs. Whatever scale economies could be realised from amalgamation should be considered alongside the additional costs of the shift from self- to full regulation. More importantly though, the administrative costs are only a small portion of the total economic costs of regulation. Other more significant considerations are likely to be the impacts of any merger on the compliance and deadweight costs of regulation in the gas and electricity sectors.

A proper analysis of the costs and benefits of merging the two regulators would need to consider:

- the problems that a merger is seeking to address. At this stage it appears to us that the principal concerns are the adequacy of disclosure in the gas sector and some concerns around the effectiveness and scope of the GIC;
- the different options for addressing the problem(s). There may be more direct and less costly means of addressing the core problems than merging the two regulators. **These options include changes in the GIC's objective, legislated scope, processes for budget and workstream setting and rules around term limits.**
- the pros and cons of the different options. Alongside other factors discussed in this note, we suggest the costs and uncertainty of a change in regulation structure, and options for private responses (contract or business structure) to disclosure and security of supply issues, are also relevant to the case for joint regulation.

Next steps

From here we will seek further engagement with the GIC in particular to discuss the feedback from stakeholders and develop our analysis of the options for changes in governance, regulation and legislation.