COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Review of the Commerce Commission's funding for the regulation of electricity and gas networks under Part 4 of the Commerce Act 1986

Discussion paper

10 December 2020

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Executive Summary

1. Electricity and gas networks provide essential services, which both households and businesses rely on. For households, energy means heating and lighting their homes; for businesses it can be a significant cost which affects the price at which they can offer their goods and services to consumers.

2. Over the past decade, the energy landscape has changed and so have the expectations on us as the economic regulator of electricity and gas networks. For example, the Electricity Price Review highlighted the need for regulators to engage more and better with consumers; and issues like energy affordability, innovation, and decarbonisation are important features of the energy landscape.

3. In conjunction with our monitoring agency, the Ministry of Business, Innovation and Employment (MBIE), we are reviewing our ongoing funding requirements and are interested in understanding the views of industry levy payers and other stakeholders. The review is aimed at ensuring our funding levels allow us to fulfil our statutory functions and meet stakeholder expectations for our role, including continuing to operate as a credible and effective economic regulator. The review focuses on regulated energy businesses rather than all regulated businesses under Part 4 of the Commerce Act 1986 (Part 4), and we propose to retain the current level of funding for airports at this time.[1]

Our proposal to deliver on regulatory responsibilities and meet changing expectations

4. As it stands, without an increase in our funding we will be able to meet only our minimum statutory obligations and will not be able to meet the expectations of consumers, government, and industry participants.

5. The main drivers of the proposed increases are:

   5.1 Ensuring we are adequately resourced to shine a light on the performance of regulated businesses through our summary and analysis function.

   5.2 Meeting consumers', and the government's, expectations for the way we engage with consumers in making decisions that affect them.

   5.3 Engaging effectively with all regulated businesses and wider stakeholders so that we can understand their needs and constraints and plan ahead.

   5.4 Proactively monitoring compliance with, and enforcing, the rules we put in place in a timely way to minimise harm to consumers.

   5.5 Reviewing the input methodologies (the rules, processes and requirements underpinning the regulation of electricity and gas networks) before the end

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[1] Regulated airports will however need to contribute to the review of the rules, requirements and processes that govern how we regulate airports. These are known as input methodologies.

of 2023 to ensure they remain fit for purpose. By its nature, this work is resource intensive, and it is currently unfunded.

5.6 Contribution to cost pressures associated with growth in the overall size of the organisation, including costs associated with corporate services and business management.

6. Funding for our work under Part 4 has not been reviewed since 2013. Since then the expectations on our regulation of energy networks have evolved.

7. In today's world, the form and style of economic regulation needs to be increasingly dynamic to respond to new technology, new services which can offer better value for consumers, consumer behaviour, the availability and accessibility of data and information, and the ways in which different regulated businesses with different governance structures respond to these changes.

8. Modern regulators need skills in data analysis, consumer engagement, behavioural economics, and understanding of the needs of different stakeholders, along with the ability to identify where they can deliver the biggest overall benefit to existing and future consumers.

9. The Part 4 regulatory regime is complex and has a number of dimensions. This means that already we are not doing all we could do in using our powers and functions and out of necessity are spending more a year than our implied budget (a pro rata cut of our five-year budget). We will always do the best we can for New Zealanders with the resources available. However, without an increase in our funding, we will need to narrow our focus to delivering price-quality paths, rather than expanding our focus to meet the full expectations of consumers, industry participants, Parliament and government.

How much will it cost and who will pay

10. In 2019/20, we spent $8.5M on the regulation of energy networks under Part 4.

11. In this paper we have proposed funding of $12M per year for the period 2021/22 – 2025/26 for the ongoing running of the Part 4 regime for energy networks, comprising $9M for electricity and $3M for gas This would amount to an increase in our electricity and gas appropriations of $4.4M a year over the funding level last reviewed in 2013.[2]

12. The cost on NZ households under our proposed level of funding is 57 cents per month or 0.33% of their average energy expenditure. This is up from 41 cents per month on our 2019/20 spending.

[2] Calculated using the 5-year average of our current 5-year multi-year appropriations for electricity and gas.

13. In addition, we are seeking $8M for the next review of the input methodologies (or 'IMs') spread over two years (2021/22 and 2022/23). For comparison, the previous IM review cost $7.65M.

14. Any increase in levies would be paid by existing levy payers. This ultimately flows through to consumers.

Outcomes that consumers and the industry can expect to see

15. The proposed level of funding has been informed by our medium-term priorities for the regulation of electricity and gas networks. These priorities are grounded in the purpose of Part 4, which is to promote the long-term benefit of consumers.

16. Drawing on the purpose of Part 4, the extent to which electricity and gas networks are performing for the long-term benefit of consumers can be thought about across six areas: innovation, investment, quality, pricing, profitability and efficiency.

17. Within each of these performance dimensions we have made an assessment of where the energy sector is currently and where we would like it to be by 2026. We call this 'bridging the gap', and it is our preferred funding option.

18. Under this funding option, we will work to bridge the gaps in sector performance using our full range of tools, including:

    18.1 Increasing the level of effort and attention we commit to performance monitoring and reporting. This work will have a renewed emphasis on monitoring of the risks to network reliability and resilience. This is particularly important work as it can help bring to light weaknesses in asset stewardship, thereby protecting consumers from network deterioration that, if not addressed early, can lead to poor quality of service or large future price shocks.

    18.2 Continuing to ensure that consumers are protected against excessive profits through setting and enforcing price-quality paths. This will continue to be supported through making the profitability of electricity and gas networks transparent through information disclosure.

    18.3 Taking a more proactive approach to our compliance work, to ensure consumers are protected. This will include a greater emphasis on educating and supporting regulated businesses to comply with the rules we set.

    18.4 Increasing our outreach and engagement to build wider and deeper connections with market players, including innovators and consumer groups alike. We want to hear points-of-view in less formal settings. Consumers can expect to see us being more proactive, visible, and accessible to understand their needs, preferences, and concerns. We have found that our ability to regulate is improved when appropriately resourced participants with a consumer perspective can provide considered and well-informed input into our work.

18.5 Reviewing the rules that underpin the regulation of energy networks to ensure they remain fit for purpose in light of the changing energy landscape.

19. We consider this 'bridging the gap' strategy and funding option is needed to enable us to meet stakeholder expectations of our role.

Other funding options considered

20. During this review, we also considered three other funding options shown in the Table below. Having assessed all these options, we consider that 'bridging the gap' offered the most value to industry and consumers at this time.

No new funding $7.4M per annum (comprising $5.5M for electricity and $1.9M for gas)	No new funding for Part 4 generally would mean reducing staff numbers from current levels (2020/21 year) and concentrating primarily on price-quality path resets. This would not meet the expectations of consumers, industry participants and government. As such, we do not consider this to be a feasible option.
Holding the line $10.4M per annum (comprising $7.7M for electricity and $2.7M for gas) $8M for IM review	This level of funding would maintain the status quo from a resourcing and output perspective but we would be unable to meet the increased stakeholder expectations on us, particularly in terms of consumer engagement expectations and our ability to deliver high value monitoring and reporting.
Bridging the gap (recommended option) $12M per annum (comprising $9M for electricity and $3M for gas) $8M for IM review	This is the level of funding we need to meet stakeholders' increased expectations of our role in the electricity and gas sector.
Bridging the gap+ $13M per annum (comprising $9.7M for electricity and $3.3M for gas) $13M for IM review	This level of funding would have all the benefits of 'bridging the gap' as well as further investment in our internal skills and capabilities, and an increased focus on international engagement to be at the forefront of anticipating regulatory needs in the face of global technological change. For the IM review, it would allow a more

	comprehensive review and a simplification of the input methodologies to make them easier to navigate and engage with.

21. Under all funding scenarios (except 'no new funding'), we propose additional funding to effectively undertake the next input methodologies review, which is currently unfunded. No additional funding for the input methodologies review would mean carrying out a minimal review of the input methodologies, which we are required by legislation to review before the end of 2023. The input methodologies are an important part of the regulatory and legislative regime designed to provide certainty for businesses and investors. A decision not to amend aspects of the input methodologies as part of the review is also subject to merits appeal. Given all this, there is a high risk in having no or inadequate resourcing in this area. As such, we do not consider this to be a desirable option.

We want your feedback

22. We want to hear from you on our preferred funding option and get your thoughts on the type of economic regulator you believe will best serve New Zealand into the future.

23. Your feedback will:

    23.1 inform MBIE's advice to the Minister of Commerce and Consumer Affairs on funding our regulatory work under Part 4 from July 2021 onwards; and

    23.2 help shape the medium-term planning of our work programme.

24. You can upload your response by 5pm Friday 12 February 2021 by accessing this link: https://comcom.govt.nz/file-upload-form-folder/file-upload-form. Please select 'Levy consultations 2020' from the drop down for the **Submission Topic**.

25. We are open to meeting with affected stakeholders to discuss this funding review in the new year. Any party that would like to meet in person can register their interest at regulation@comcom.govt.nz before 23 December 2020.

Chapter 1: Introduction

26. This consultation paper seeks views on the levy funding needed for the Commerce Commission as a result of increased workload and expectations for our role in regulating electricity and gas networks, under Part 4 of the Commerce act 1986 (Part 4), including the upcoming review of input methodologies (or 'IMs') which we must complete before the end of 2023.

27. Your feedback will inform the Ministry of Business, Innovation and Employment's (MBIE) advice to the Minister of Commerce and Consumer Affairs on the appropriate level of funding and levies for our work in the energy sector from July 2021 onwards.

Question 1
Do you have any feedback on the purpose and objectives of this consultation paper?

A stable regulatory regime with increased expectations

28. Electricity and gas play an essential role in the lives of people and businesses.

29. We have been regulating energy networks under Part 4 since regulatory reform in 2008. Since then, we have delivered a stable regime that is delivering increased certainty and consumer benefits envisaged by policy makers. These benefits have been realised through a focus on setting the up-front rules and the associated regulatory requirements that must be met by infrastructure providers.

30. In recent years, the energy sector – and our role in the sector as the regulatory regime matures – has come under increased scrutiny for a variety of reasons, including concerns about energy affordability, asset management and decarbonisation. Public scrutiny and expectations increased as a result of natural disasters and COVID-19 and the impacts these events have had on infrastructure providers and their consumers.

31. Our funding for this work is through multi-year appropriations in electricity and gas, equivalent to \$5.6M and \$1.93M a year respectively. These appropriations have not been reviewed since 2013. We also received funding of \$4.93M for the first review of the input methodologies, which contributed to the \$7.65M total cost of that review.[3]

32. Against this backdrop, we face increasing expectations in a number of areas, including:

    32.1 shining a light on the performance of regulated businesses through our summary and analysis function and targeting areas of potential concern;

[3] We also receive funding directly from applicants requesting customised price-quality paths.

32.2 meeting consumers', and the government's, expectations regarding the way we engage with consumers in making decisions that affect them;

32.3 engaging effectively with all regulated businesses and wider stakeholders so that we, and they, can plan;

32.4 monitoring compliance with, and enforcing, the rules we put in place; and

32.5 reviewing the input methodologies (the rules, processes and requirements underpinning the regulation of electricity and gas networks and specified airport services) before the end of 2023 to ensure they remain fit for purpose.

Meeting the expectations of consumers, industry participants and government

33. In the absence of additional ongoing funding, the Commission will be unable to meet the expectations of consumers, industry participants and government. Further funding is needed to enable us to keep pace and help deliver good outcomes for consumers. Greater scrutiny of regulated businesses and setting the right incentives for a changing world can deliver benefits far in excess of the cost of the resource.

34. We currently have a five-year budget to the year 2023/24. In the first two years of this financial period, we met the demands of the statutory framework for price-quality path decisions by expanding our resources beyond the level implied by a straight pro rata split of the five-year budget. However, this is not sustainable and reducing expenditure in the remaining three years of the five-year period to compensate for this would mean not being able to carry out all our statutory functions or meet stakeholder expectations.

35. We will do the best we can for New Zealanders with the resources we have. With current funding, we would have to reduce staff from current levels and focus on the mandatory, statutory requirements of the regime. This would involve some scaling back of activity and putting some activities on hold, particularly on monitoring and analysis of industry performance.

36. With current funding, we would not be able to engage effectively with stakeholders on a range of fronts, from planning future price-quality paths, to designing regulation that anticipates longer-term developments in the energy sector. We would not be able to engage effectively with energy consumers on what matters to them. Neither would we be able to use our information disclosure and summary and analysis powers to shine a light on relative performance of regulated businesses and identify issues before they result in consumer harm or a failure to comply with obligations.

37. Our ability to take prompt action in similar circumstances to the case of Aurora Energy would be impeded. If we do not receive funding for the review of input methodologies, we would need to refocus our resources drastically for the two years of the review and would, at best, only be able to conduct a minimal review of the input methodologies.

38. Growth in our activities is also contributing to cost pressures not directly tied to energy regulation but associated with the growth of the organisation. Including the impact of new functions such as telecommunications regulation, market studies, consumer credit, and other changes in our regulatory responsibilities, in the last few years, we have grown from an organisation of 180 staff to 250 staff. Each area of regulatory responsibility must contribute its share of the step-change in costs associated with the running costs of an organisation, including regulatory functions that are levy funded such as energy regulation. For example, there are increased costs associated with corporate services and business management. However, the overall indirect costs for each regulated sector remain much lower than those that would arise with a stand-alone regulator for each sector or an economic regulator that was not also a competition and consumer agency.

39. A reduction in activity would run counter to the purpose of Part 4 and the expectations of stakeholders.

40. In the rest of this paper, we provide our assessment of the impact of the increase in expectations about our role in the sector and requirements on us that are currently unfunded. Businesses and consumers must have confidence in us as we work to promote the outcomes that Part 4 seeks to achieve.

> Question 2
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> Please provide feedback on whether you agree with how we have characterised the operating context of our work – in terms of a regulatory regime with increased expectations – in relation to our regulation of electricity and gas networks.

How to provide your views

41. We want to hear from you on our preferred funding option and get your thoughts on the type of regulator you believe that will best serve New Zealand into the future.

42. Your feedback will inform advice to the Minister of Commerce and Consumer Affairs on funding for our regulatory work under Part 4 for the next five years starting July 2021. It will also help shape our medium-term planning of our work programme.

43. Stakeholders are also encouraged to provide written responses on the proposal discussed in this document and the specific questions put forward. The questions are provided throughout the document and listed in Attachment D. Your submission does not necessarily need to answer all of these questions. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

44. You can upload your response by 5pm Friday 12 February 2021 by accessing this link: https://comcom.govt.nz/file-upload-form-folder/file-upload-form. Please select ‘Levy consultations 2020’ from the drop down for the **Submission Topic**.

45. We are open to meeting with affected stakeholders to discuss this funding review in the new year. Any party that would like to meet in person can register their interest at regulation@comcom.govt.nz before 23 December 2020.

46. The timeline for this consultation process and levy review is set out below:

10 Dec 2020	Consultation opens for submissions
12 Feb 2021	Last day for submissions
Feb/Mar 2021	Submission analysis and policy/budget development
Mar/Apr 2021	Cabinet consideration
Jul 2021	Any levy changes commence

47. In addition to this consultation process, we are also currently consulting with stakeholders on levy funding requirements in relation to our work regulating the telecommunications sector.[4]

[4] Available at https://comcom.govt.nz

Chapter 2: The changing energy landscape

The energy trilemma

48. Energy equity (includes accessibility and affordability), environmental sustainability (includes decarbonisation) and energy security together are known as the 'energy trilemma'. There are often conflicts and trade-offs between these three aspects of the trilemma that are difficult to reconcile.

49. Pre-COVID, New Zealand ranked 10th overall on the World Energy Council's Energy Trilemma Index out of the 128 countries measured. Nevertheless, New Zealand still faces challenges across aspects of the energy trilemma, which has an ongoing impact on electricity and gas networks and our work in regulating them:

    49.1 Energy equity (particularly affordability) has been in the spotlight through the last Government's Electricity Price Review. The Review found that more than 100,000 households in New Zealand face energy poverty, that residential consumers in some places appear to be paying more than they should compared to business customers, and that consumers are sharing unequally in the benefits of increased retail competition.

    49.2 Environmental sustainability and efforts to decarbonise have the potential to significantly increase electricity consumption – both in aggregate and at specific sites (eg, where industrial consumers switch from gas or coal to electric power sources for plant). Relatedly, as highlighted by the Electricity Price Review, innovative technology and business models present opportunities for supporting decarbonisation efforts. However, the Review also noted the equity aspects of innovative technology and the risks that the costs and benefits of these advances may not always be evenly shared.

    49.3 Energy security, and network reliability in particular, could become more challenging in a future where more decentralised and renewable generation enters the generation mix, and the electrification of the economy accelerates.

50. Within the bounds of the Commerce Act, we have a role to play in a number of the areas outlined above. By limiting electricity and gas networks' ability to extract excessive profits, and providing incentives for networks to improve efficiency, we contribute to energy affordability. By setting quality standards and providing networks with incentives to invest and innovate, we contribute to network reliability and security of supply. Our funding proposal reflects our expectation of continuing to contribute to these objectives.

51. It is also worth noting that this landscape is not static. We will need to ensure our regulatory regime is flexible enough to respond to different pathways of greater electrification on the one hand, and potentially declining gas use on another. The direction and speed of change will also be influenced by factors such as the Climate Change Commission's advice to Government next year on its first Emissions

Reduction Plan as well as the 30-year Infrastructure Strategy currently being developed by the Infrastructure Commission.

Asset stewardship

52. Sound asset stewardship of electricity and gas networks is critical to ensuring that these networks reliably deliver the services that consumers demand now and into the future. Failure to do so can mean consumers facing much higher costs in future to make infrastructure safe and reliable.

53. Electricity networks are grappling with how to best manage long-lived assets built many decades ago. Effective asset stewardship of ageing networks has become even more complicated in a changing environment of new technologies—such as solar PV, storage and electric vehicles—and changing consumer preferences. We need to create the right regulatory environment for this, working closely with the Electricity Authority which regulates many aspects of New Zealand's electricity market. This includes creating the right incentives for network businesses to use new technology or services as an alternative to infrastructure where these represent better value for money for consumers. Nevertheless, it remains the responsibility of network businesses to ensure they are investing sufficiently in their networks and at the right time, ensuring appropriate levels of network resilience. To do this, network businesses must build and maintain a sound understanding of the health and criticality of their assets.

54. The Aurora Energy electricity network in Dunedin, Central Otago and Queenstown Lakes illustrates the importance of sound asset stewardship. Earlier this year, Aurora was ordered by the High Court to pay a penalty of almost $5 million, after the Commission brought proceedings against Aurora for contravening network quality standards through an excessive level of power outages in the period from 2016 to 2019. Our investigation found that Aurora's historic under-investment in asset maintenance and renewal including of its poles, cables and transformers resulted in a material deterioration in Aurora's service quality. Aurora is now preparing to undertake significant catch-up investment on its network, which was predominantly built in the 1950s and 1960s. This investment will result in considerably higher future prices for Aurora's consumers.

55. Sound asset stewardship is also critical for gas pipeline businesses. Risk management is a particularly important component of this. For example, buried gas pipelines are susceptible to accumulated strain, bending and possible rupture effects from soil movements and other geohazards – including earthquakes and coastal erosion. Where this occurs, it may lead to loss of containment with associated health and safety, loss of supply, environmental, reputational and cost impacts. It is therefore important that gas pipeline businesses have sound management processes and systems in place to identify and assess risks, including geohazards, and determine whether and how to monitor or remediate, and to prioritise remediation works.

56. Asset knowledge will also be critical in addressing questions about the future of gas. The drive towards decarbonisation means that decisions on when and how to

maintain or renew gas infrastructure will be increasingly difficult. Businesses will need to understand their assets and all the risks in play to make decisions which are in the interests of consumers.

Emerging technology, business models, and consumer preferences

57. Technology, new services and business models, and consumer preferences continue to evolve. This presents opportunities and risks for both network businesses and consumers.

58. For network businesses, new technology has the potential to offer more innovative, bespoke, and efficient ways of delivering electricity to consumers, while supporting decarbonisation efforts. However, it also complicates decision-making on network investment, which has traditionally been based on centralised infrastructure that is long-term in nature.

59. For consumers, new technology and business models have the potential to deliver new services. Many of these emerging markets have the potential to be contestable – raising questions about the benefits and risks to consumers of electricity distributors' participation in such markets. We need to make sure the regulatory regime facilitates new technology and services so that consumers can benefit both directly and through potential savings in the costs of providing network services. This is something we need to continue to explore.

Question 3 Please provide feedback on whether you agree with how we have characterised the changing energy landscape in relation to electricity and gas networks. Are there other sector factors that you think are important?

Chapter 3: Increased expectations of the Commission

60. The changing energy landscape has coincided with an increasing expectation that public sector organisations, such as ours, work collectively and collaboratively with others to improve living standards for New Zealanders.

61. Part of the motivation for the Public Service Act 2020, for example, was to make the public sector more citizen-focused. This area of emphasis was also echoed in the findings of the Electricity Price Review in relation to the way we engage with consumers and the people that are impacted by our work.

62. Changes of this nature are reflected in the expectation of the Minister of Commerce and Consumer Affairs that we "maintain strong and trusted relationships with the diverse range of stakeholders with interests in the sectors regulated under Part 4 of the Commerce Act 1986. This should include, in the implementation of Part 4, taking into account the views of consumers, small businesses, regulated suppliers and investors and seeking out opportunities to enhance confidence in the regime."[5, 6]

63. We welcome the Government's planned establishment of a Consumer Advocacy Council. We expect that the Council will have a valuable role in strengthening the consumer voice by providing input to our regulatory decision-making processes on behalf of residential and small business electricity consumers. Once established, the Council will be a key stakeholder for us and, as part of our work to improve our consumer engagement, we will consider how we can most effectively engage with the Council.

64. The Minister of Commerce and Consumer Affairs also highlighted his expectations that we:[7]

    64.1 "Promote the effective management of, and innovation and investment in, regulated infrastructure assets, and thereby contribute to ensuring their resilience (including their resilience to significant natural disaster events) and ability to meet the challenges of new technology and transitioning to a low-carbon economy."

    64.2 "Collaborate constructively with other regulators where matters of common interest exist, particular where there may be competing regulatory objectives, gaps or overlaps in regulatory mandates."

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5 Annual letter of expectations for 2020/21, Minister of Commerce and Consumer Affairs, 12 March 2020, available at https://comcom.govt.nz/__data/assets/pdf_file/0012/215211/Ministers-Letter-of-Expectations-2020-21-12-March-2020.pdf

6 These expectations are also reflected in the enduring expectation that Statutory Crown Entities operate as part of "a high performing public sector that is strongly focussed on improving current and future wellbeing". Enduring Letter of Expectations, Minister of Finance and Minister of State Services, 15 October 2019.

7 Annual letter of expectations for 2020/21, Minister of Commerce and Consumer Affairs, 12 March 2020, available at https://comcom.govt.nz/__data/assets/pdf_file/0012/215211/Ministers-Letter-of-Expectations-2020-21-12-March-2020.pdf

64.3 "Contribute to policy discussions with MBIE by providing expert assistance in the Commission's areas of expertise and practical guidance on the workability and resource requirements of proposed policies impacting the Commission's functions, powers and duties; for example, in response to the Electricity Price Review's recommendations that fall within the Commission's mandate."

Electricity Price Review

65. The last Government initiated the Electricity Price Review in April 2018 to "ensure that the New Zealand electricity market delivers efficient, fair and equitable prices as technology evolves and we transition to a lower emissions future, taking into consideration the requirements of environmental sustainability and the need to maintain security and reliability of supply – the energy trilemma." The Electricity Price Review reported back to the Government in May 2019, making 32 recommendations. The Government has since agreed to a work programme that will see 20 of the Review's recommendations progressed immediately, many of which directly or indirectly have an impact on the electricity distribution sector and our work in regulating it. This includes:

65.1 improving outreach and consumer engagement;

65.2 encouraging innovation to support decarbonisation;

65.3 pricing, including removal of the low fixed charge tariff requirements; and

65.4 reviewing institutional arrangements and various powers of the Commerce Commission and the Electricity Authority.

66. The Minister of Commerce and Consumer Affairs wrote to us in December 2019 setting out his expectations of the Commission following the Electricity Price Review. In particular, his letter:

66.1 highlighted his expectation that we review our consumer engagement practices for our electricity work under Part 4;

66.2 invited us to implement regulation under Part 4 in a way that encourages innovation among electricity distributors.

67. The Minister's letter and our response are available on our website.[8]

68. Our funding proposal in this consultation document reflects the need to respond to the Minister's letter of expectations following the Electricity Price Review.

Expectations of a modern regulator

69. The Commission is at the forefront of making sure consumers and industry have access to fundamental services on which they are dependent on a day-to-day basis.

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[8] https://comcom.govt.nz/about-us/strategic-planning-and-accountability-reporting/ministers-letter-of-expectations

The regime we operate under Part 4 is complex in many respects and was developed some years ago.

70. Economic regulation exists where there is no or limited competition in order to:

70.1 replicate the effect of competition;

70.2 ensure that prices are fair;

70.3 ensure consumers are protected; and

70.4 ensure companies invest and are customer-responsive and innovative.

71. Economic regulators are found in all 37 member countries of the OECD and regulators around the world have demonstrated that the level of savings they deliver through their work far outweigh the cost in resources.

72. But there can also be a cost of poor regulation. The NZ Productivity Commission summed this up in June 2014:

> Regulation is a fact of life. It affects the food we eat, the houses we live in, the goods and services we buy and sell, and our ability to earn a living. Regulation plays an important role in guarding New Zealanders from harm, protecting our rights, and ensuring that markets work fairly and efficiently. However, when regulation is badly designed or implemented, it can fail to provide these protections or place unnecessary burdens on personal freedoms and business efficiency. Poor regulation leads to pressure for more regulation.

> Question 4
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> Please provide feedback on whether you agree with how we have characterised the increased expectations on the Commission.

Chapter 4: Delivering consumer outcomes in electricity and gas networks

73. Our strategy for the regulation of electricity and gas networks is grounded in the purpose of Part 4, which is to promote the long-term benefit of consumers.

74. Drawing on the purpose of Part 4, the extent to which electricity and gas networks are performing for the long-term benefit of consumers can be thought about across six areas: innovation, investment, quality, pricing, profitability and efficiency.

75. Within each of these performance dimensions we have made an assessment of where the energy sector is currently and where we would like it to be by 2026. We call this 'bridging the gap'.

'Bridging the Gap': Where are we now, and where do we want to be in the future?

Investment and quality

76. Investment and quality are two related dimensions of performance. At the heart of investment and quality performance is asset stewardship, which is a core role for electricity and gas network businesses. Sound asset stewardship is an integral part of ensuring that distributors improve efficiency and provide services at a price and quality that reflects the demands of electricity consumers, as well as comply with other regulatory obligations, such as in relation to safety. Currently, we are not confident that the majority of electricity distributors have a sound understanding of the condition and criticality of their assets.

77. A recent review we undertook of gas pipeline businesses' risk management practices found that those practices were generally in good shape. However, the review recommended a number of improvements, including in relation to asset criticality, resilience, cost benefit analysis, asset data accuracy and customer expectations.

78. By focusing resources on the right areas and working with the industry, by 2026 we want to see that all electricity and gas networks:

    78.1 have a good understanding of what their customers need, and what they are offering to their consumers;

    78.2 have asset management practices directed at supplying services at the quality consumers demand, and that are underpinned by an understanding of asset condition, criticality and risk, and appropriate levels of resilience; and

    78.3 consistently achieve the core quality measures and are starting to respond to any broader measures we put in place.

Innovation

79. Electricity distributors have to deal with an ever-increasing range of complex issues, including those related to new technologies, energy affordability, cybersecurity, health and safety, climate change and decarbonisation, often involving diverse stakeholder views. In particular, distributors are grappling with how to best manage

long-lived assets built many decades ago, while taking into account the opportunities and risks associated with emerging technologies.

80. There is a risk that innovation by electricity distributors might potentially harm consumers by:

 80.1 reducing competition in adjacent or downstream markets; or

 80.2 increasing the prices that consumers pay for assets that deliver no real benefit.

81. A number of the gas pipeline businesses have commenced work on understanding the impacts and opportunities for their networks from changing technologies, or are exploring how to adapt to the challenges presented by decarbonisation – for example, by considering the feasibility of lower carbon alternatives or blended uses for gas pipelines, such as biogas and hydrogen.

82. By 2026, we want to see:

 82.1 the leading-edge electricity networks seeking out and adopting innovative technologies and articulating the benefits to consumers of those technologies;

 82.2 electricity networks adapting their business models to embrace new ideas to deliver benefits to consumers; and

 82.3 that gas networks are adapting to decarbonisation.

Efficiency

83. It is important that networks continue to strive for efficiency gains, which can ultimately be shared with consumers through lower prices. There is currently not significant evidence to suggest that networks are becoming more efficient. There is some informal benchmarking done by networks against their peers shared amongst networks, but there are opportunities for both networks and the Commission to do more of this.

84. By 2026, we want:

 84.1 to increase our ability to track the efficiency of electricity and gas networks;

 84.2 to see an improvement in the average efficiency of networks; and

 84.3 industry participants to be more aware of network businesses' efficiency and for network managers to be looking to actively compare themselves against their peers in pursuit of efficiency gains.

Profitability

85. Profitability is an important performance dimension because it directly impacts the prices paid by consumers while also ensuring that network owners continue to invest in their networks. Through the setting of price-quality paths, we allow price-quality-regulated businesses to earn an appropriate level of profit. Information disclosures have not revealed any significant concerns about the profitability of consumer-owned distributors, which are exempt from price-quality regulation.

86. Consequently, examining networks' profitability is not an area where we see a significant gap to be closed over the next five years. However, it is important that we continue to be adequately resourced to deliver effective price-quality path resets and to monitor profits through our summary and analysis work.

Pricing

87. Pricing of network services is an important issue for the electricity distribution sector, as it affects how networks recover their costs from their customer bases. The Electricity Authority is the primary responsible agency in this area, promoting more efficient pricing through its work on distribution pricing principles, practice notes, and scorecards. We will continue to support the Authority in this work, rather than independently seeking to close any gaps in this area.

Question 5 Please provide feedback on how we have characterised our approach to delivering consumer outcomes in electricity and gas networks and our focus on 'bridging the gap'. Are there other outcomes you would expect to see with the additional funding we are seeking in the consultation document?

Chapter 5: Implied workplan and costing for our energy work

88. Using the right tools at the right times to make sure we prioritise the work of greatest impact at a time of a changing landscape and stakeholder expectations is fundamental to ensuring we focus on delivering 'bridging the gap' and are able to bring the greatest value to New Zealanders.

89. To undertake this work, it is our assessment that it will cost $12M per year to run the energy portfolio excluding the IM review. This comprises $9M for electricity and $3M for gas. Altogether, it consists of 41 full time equivalents and $1.3M in external costs.

	Energy		
	3 Year historic spend	*Our preferred option*	*$ Change*
Setting and removing rules			
Internal costs	*$3.739m*	*$5.35m*	-
External costs	*$0.296m*	*$0.50m*	-
Sub total	*$4.035m*	*$5.85m*	*$1.82M*
Analytics & Insights			
Internal costs	*$1.693m*	*$2.62m*	-
External costs	*$0.324m*	*$0.20m*	-
Sub total	*$2.017m*	*$2.82m*	*$0.80M*
Compliance & enforcement			
Internal costs	*$0.902m*	*$1.41m*	-
External costs	*$0.292m*	*$0.25m*	-
Sub total	*$1.195m*	*$1.66m*	*$0.47M*
Outreach & Engagement			
Internal costs	*$0.351m*	*$1.33m*	-
External costs	*$0.043m*	*$0.35m*	-
Sub total	*$0.394m*	*$1.68m*	*$1.29M*
TOTAL	***$7.642m***	***$12.01m***	***$4.37M***

90. In this chapter we outline how we will approach our role in regulating electricity and gas networks if we are to meet the expectations and bridge the gaps described above.

91. To 'bridge the gaps' in the sector we have a number of tools available to us under the Commerce Act. They are:

    91.1 Setting and removing rules – which includes creating financial incentives through revenue limits and quality standards;

91.2 Analytics and Insights – which includes improving transparency about network businesses' performance, including relative performance, which can affect the reputation of the business and its relationships with stakeholders;

91.3 Compliance and Enforcement – which includes taking action to ensure network businesses comply with their obligations and taking appropriate enforcement action if they do not; and

91.4 Outreach and Engagement – which is important for, amongst other things, ensuring that our decisions are informed by an understanding of consumers' views and preferences.

92. In the rest of this chapter we outline the work that we will undertake to help 'bridge the gap'.

Setting and removing rules

93. We will ensure that consumers continue to be protected against excessive profits through setting and enforcing price-quality paths. This will continue to be supported through making the profitability of electricity and gas networks transparent through information disclosure.

94. The quality of service consumers receive will continue to be maintained through the setting and enforcing of quality standards, and by requiring the disclosure of information about network performance. To enhance this, we intend to consult on expanding the range of quality measures that electricity networks are required to report against to ensure that networks are measuring and reporting on service quality in a way that is meaningful to consumers.

95. To further incentivise innovation to support decarbonisation, we intend to undertake a targeted review of our information disclosure requirements to increase transparency about the extent to which distributors are innovating (amongst other things). This review would also:

95.1 present an opportunity to address recommendations by the Electricity Authority's Innovation and Participation Advisory Group intended to improve the use of distributed energy resources, such as rooftop solar; and

95.2 allow us to explore options for further incentivising innovation and decarbonisation through future price-quality paths.

96. Under this approach we will continue to deliver on our responsibilities to set and administer price-quality regulation, including:

96.1 every five years, carrying out our statutory requirements of:

- setting default price-quality paths for over half of the country's 29 electricity distribution businesses;

- setting an individual price-quality path for Transpower; and
- setting default price-quality paths for gas pipeline businesses.

96.2 From time to time, we must also consider applications for customised price-quality paths from those electricity distribution and gas pipeline businesses that apply.[9]

96.3 The price-quality paths also require ongoing administration. For example, assessing applications to reopen the price-quality paths. For example, an electricity distributor may apply to us for an increase to its revenue allowance to meet the costs of large distributed generation and large unforeseen industrial connections, such as due to the electrification of process heat.

96.4 Assessing applications from Transpower for additional revenue to deliver certain capital expenditure projects. For example, where major capital expenditure is required to upgrade the national grid.

Analytics and Insights

97. Performance monitoring and reporting that shines a light on the performance of regulated businesses is an effective and efficient way of incentivising businesses to improve their performance in line with the interests of their consumers. To date, we have not had the opportunity to deliver as much of this work as is needed, as our resources have been committed to larger pieces of work with statutory deadlines, such as the setting and re-setting of price-quality paths.

98. Under this proposal, we will increase the level of effort and attention we commit to performance monitoring and reporting. This work will have a renewed emphasis on monitoring of the risks to network reliability and resilience. This is particularly important work as it can help bring to light weaknesses in asset stewardship, thereby protecting consumers from network deterioration that, if not addressed early, can lead to poor quality of service or large future price shocks.

99. We will also undertake targeted monitoring and public reporting on other areas of performance that stakeholders are interested in, such as innovation and efficiency, and improve our understanding of the form and content of information that different stakeholders are interested in.

100. We will continue our work to make the performance information disclosed by regulated businesses more accessible to the public. For example, we will continue to develop our Performance Accessibility Tool, which currently allows those interested

[9] Our costs associated with asssessing customsied price-quality path proposals are met by the regulated business making the application, and so are not covered by this funding proposal.

in the performance of electricity distributors to explore and compare performance information in a visual way.[10]

101. We will develop a deeper understanding of the regulated businesses and how they operate, including a greater capacity to address issues that arise while also working to understand their context. This approach will put us in a position to be more proactive in addressing systemic issues for the long-term benefit of consumers.

102. With a clearer picture of the performance of networks we will be able to share better information with consumers about how their networks are performing, incentivise the continuous improvement of network performance, and better target our interventions at the areas that matter most.

Compliance and Enforcement

103. Monitoring compliance with regulatory requirements, and taking enforcement action where necessary, is an enduring priority of the Commission.

104. Resolving contraventions of the quality standards for electricity distributors remains a key focus for us. However, we currently face a significant backlog of cases. This proposal would allow us to reduce the current compliance backlog significantly, which would strengthen electricity distributors' incentives to comply with the quality standards and to deliver the service consumers are paying for.

105. Continuing to develop compliance and enforcement expertise will also help us prioritise action that is of the greatest benefit to consumers and to use whichever tools are proportionate to the circumstances. This will benefit consumers and businesses as we will all be able to focus on the issues which matter most.

106. More generally, under this proposal our compliance work would be more proactive and place greater emphasis on educating and supporting regulated businesses to comply with the rules we set. To this end, we intend to publish enforcement guidelines and guidance, which will support businesses in making the best choices by their customers through providing clarity on the factors we consider when making enforcement decisions.

Outreach and Engagement

107. Historically, our engagement has centred around market participants directly involved in formal processes, but we want to build wider and deeper connections with market players, including innovators, and consumer groups alike. We want to hear points-of-view in less formal settings.

108. Consumers can expect to see us being more proactive, visible, and accessible to understand their needs, preferences, and concerns. We have found that our ability

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[10] See https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-distributor-performance-and-data/performance-accessibility-tool-for-electricity-distributors.

to regulate is improved when appropriately resourced participants with a consumer perspective can provide considered and well-informed input into our work.

109. We are currently reviewing our stakeholder engagement processes for our electricity work under Part 4. The review is aimed at ensuring that our decision-making is well informed by the views of consumers, particularly households and small businesses. This includes ensuring we are listening to electricity consumers' views on preparing for a low-carbon economy, and considering how those views relate to our decision-making powers under Part 4.

110. Through the review, we expect to identify a range of options to improve our engagement processes. The more that we understand what is important for consumers and the choices they make, the more effectively we can reflect their interests in our work.

111. We plan on becoming better connected through:

111.1 Increasing our engagement with consumers and consumer groups by:

- getting out of Wellington and Auckland and visiting stakeholders where they live and work; and
- developing different ways consumers can connect with us – eg, focus groups.

111.2 Working more effectively across the energy markets regulatory system, including with MBIE, the Electricity Authority, the Energy Efficiency and Conservation Authority, the Gas Industry Company, and the Climate Change Commission. This approach will build on our current involvement with the Council of Energy Regulators, which takes a whole-of-system view to consider regulatory issues and trends in the electricity and gas markets, and helps to facilitate a coordinated response in addressing issues for which there are overlaps or gaps.

111.3 Increasing our sector outreach, including through:

- further investment in people with industry knowledge, expertise, and connections; and
- engaging more with stakeholders outside of statutory consultation processes, including through site visits.

111.4 Developing a deeper understanding of the regulated businesses and how they operate, and the context within which they operate. For example, through resuming our work with the Electricity Authority to examine the benefits and risks to consumers of electricity distributors' involvement in emerging contestable electricity sector markets.

112. Businesses can expect to see (where appropriate) a more collaborative channel to work through aspects of the Part 4 regime that apply directly to their operation.

Question 6 Please provide feedback on the workplan for ‘bridging the gap’ outlined above in relation to electricity and gas networks. Are there other elements of the workplan that should be included?

Chapter 6: Implied workplan and costing for the input methodologies (IM) review

Reviewing the input methodologies

113. Having completed our first review of the majority of the input methodologies in 2016, we are required by law to review the majority of them again before the end of 2023. Our current level of funding does not account for this and there is a lead time which means we must start work on the review in 2021.

114. To undertake this work, it is our assessment that it will cost a total of $8M. This is comprised of 13.5 full time equivalents and $1.24M in external costs over a two-year period (2021/22 – 2022/23).

115. For comparison, the 2016 IM review (including the Transpower Capex IM review, which took place in 2017-18) cost $7.65 million.

	IM Review		
	Initial IM review spend	*Our preferred option*	*$ Change*
Setting and removing rules			
Internal costs	*$6.64M*	*$6.76M*	-
External costs	*$1.01M*	*$1.24M*	-
TOTAL	***$7.65M***	***$8.00M***	***$0.35M***

116. The input methodologies provide the foundations for the regulatory regime and are designed to provide certainty for businesses and investors. The methodologies underpin both information disclosure and price-quality regulation. The legislative framework for the regime – whereby a decision not to amend one of the methodologies as part of a review is appealable, and the complex subject matter, means that any review is a significant, resource intensive exercise.

117. Reviewing the IMs is a significant undertaking. We recognise the importance of maintaining regulations that are stable, provide incentives to invest in long-lived infrastructure and deliver long-term benefits to New Zealanders. Under Part 4, IMs exist for electricity, gas and airports sector, which means we need to have regard to pan-sector issues in reviewing the IMs. Given the recent development of IMs for fibre regulation under the Telecommunications Act 2001, we intend to consider relevant issues and developments that arose in that context as part of the next IM review for Part 4. Cost of capital is an example of a pan-sector matter, which is complex and has material implications on the sectors we regulate and the consumers in those sectors.

118. We established a strong framework in the 2016 IM Review that will help guide the next review. Having an established framework with which to commence the next IM review is part of the reason we consider we can deliver the IM review for a similar nominal cost to the 2016 review, despite costs having gone up in that time. We took a detailed and highly consultative approach to our first IM review, which ultimately strengthened our final decision and avoided any appeals – which could have been costly both for us and industry participants. However, such a detailed and highly consultative approach takes time and money. We expect the second review should be significantly more targeted in its focus.

119. However, one area where we would look to expand on for the second review is the way we engage with consumer and community groups to ensure our decisions reflect a wider group of views.

120. There are issues that were raised through the 2016 IM review that continue to be critical and have become even more prominent for the energy sector, such as emerging technology and innovation. Regulatory rules that encourage and do not impede emerging technology and innovation in the sector are increasingly important to meeting the challenges of decarbonisation, particularly through greater electrification, as well as to meeting the changing needs of consumers and delivering value for money. It is also important that through our stakeholder engagement we listen to consumers' views on preparing for a low carbon future and work to reflect their voice and needs in our work.

121. These issues require significant engagement, time and effort to ensure our rules meet the Part 4 requirements, which includes promoting the long-term interests of consumers.

122. These statutory reviews of the input methodologies give us the opportunity to assess whether there are any necessary changes to the rules to more effectively promote the purpose of Part 4, the purpose of the IMs, or significantly reduce complexity and compliance costs, for the long-term benefit of consumers.

Bridging the gap+ for the IM review

123. We also considered the additional benefits that could be delivered with a higher level of funding for the IM review.

124. $13M, instead of $8M, for the IM review would allow a more comprehensive review and a simplification of the input methodologies to make them easier to navigate and engage with. It would also allow for more comprehensive engagement, including with stakeholders.

125. We consider we should have many of the aspirations described above, and that there are real benefits in pursuing those initiatives. However, this option was ultimately discounted because:

125.1 we are mindful of imposing additional short-term costs on consumers in the current financial climate;

125.2 we cannot be confident that the additional benefits of a more comprehensive review and simplification of the IMs would outweigh the additional costs; and

125.3 it would impose a higher consultation burden on stakeholders.

Question 7

Please provide feedback on the workplan for 'bridging the gap' outlined above in relation to the IM review. Are there other elements of the workplan that should be included? Do you agree that the 'bridging the gap' scenario for the IM review is more appropriate than 'bridging the gap+'?

Chapter 7: Reasonableness checks

126. In this section we outline a series of reasonableness checks to help put the costs of running the regulatory regime under our preferred option in perspective.

New Zealand's annual household expenditure on electricity and gas

127. Information on New Zealand households' expenditure, income, and material well-being is based on data collected as part of Statistics NZ's household economic survey (HES). Household expenditure is collected every three years.

128. The data released on expenditure in March 2020 estimates that the average household monthly spend on electricity and gas is $173. From that information we can also establish that there are 1.757M households.

129. Turning the total yearly costs of running the regime into a monthly cost per household we can determine that our preferred option will cost the average NZ household 57 cents per month or 0.33% of their average energy expenditure. This is up from 41 cents per month on our 2019/20 spending.

The ACCC: Australia's competition and economic regulatory authority

130. The ACCC is the statutory authority whose role is to enforce the Competition and Consumer Act 2010 and a range of additional legislation, promoting competition and fair trading, and regulating national infrastructure for the benefit of all Australians by:

    130.1 maintaining and promoting competition by preventing anti-competitive mergers and cartels, intervening when misuse of market power is identified, and implementing the Consumer Data Right;

    130.2 protecting the interests and safety of consumers and supporting a fair marketplace—addressing misleading behaviour, removing unsafe goods and tackling unconscionable dealings;

    130.3 driving efficient infrastructure through industry-specific regulation and access regimes; and

    130.4 undertaking market studies and inquiries to support competition, consumer and regulatory outcomes.[11]

131. The scope of the ACCC's responsibilities is close to the role of the Commerce Commission as a whole. There are population and geographical differences between the two countries.

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[11] https://www.accc.gov.au/system/files/ACCC%20and%20AER%20Annual%20Report%202019-20.pdf

132. The expenditure for the ACCC in the 2019/20 year was AUD$237M with an average staffing level of approximately 900.

133. Looking further afield, we note that resources vary significantly across regulators worldwide. For example:

133.1 BNetza, the German multi-sector network regulator, has had over 2,000 staff working on network regulation across different sectors.

133.2 Ofgem, the British energy regulator regulates both markets and networks. It has a total staff of over 800, with about 500 engaged in economic regulation. Around 100 are involved in network regulation.

133.3 The Irish water and energy regulator spends approx. $20.6M a year on energy regulation, although this includes regulating markets as well as networks.

134. Another useful reference point is the size of the businesses that are regulated under Part 4, which is shown in the table below.

	Electricity Distribution	**Electricity Transmission**	**Gas Pipeline Services**	**Specified Airport Services**
Companies	29 electricity distribution businesses	Transpower	1 transmission 4 distribution	Auckland Wellington Christchurch
2019 Regulated Assets / Revenues	$12.0B assets Revenues of $2.6b pa	$4.6B assets Revenues of $945M pa	$1.8B assets Revenues of $255M pa	$2.5B assets Revenues of $541M pa

Question 8

Please provide feedback on whether you think the additional funding we are seeking for our work in relation to electricity and gas networks is appropriate. If you think a different level of funding is warranted, please explain why.

Chapter 8: Other options we considered

135. In the process of developing the case for the preferred level of funding ('bridging the gap') we considered three other scenarios:

135.1 no new funding;

135.2 holding the line; and

135.3 bridging the gap+.

No new funding

136. In this scenario the Commission would have $7.4M of funding per year to deliver on all obligations relating to energy under Part 4.[12] Because of increasing overheads, this would require a reduction in staff numbers as compared to our current state. With no new funding we will be able to meet only our minimum statutory obligations and will not be able to meet all stakeholder expectations.

137. As we have learned over the past ten years, there is a relatively fixed level of resource required to set, reset and administer price-quality paths. This work needs to be resourced first, before we can then look at where else we can focus our efforts. As such, under a 'no new funding' scenario, we would:

137.1 continue to undertake price-quality path resets as required by the Commerce Act. We would need to keep these resets focused on updating price-quality paths and delivering only incremental improvements, rather than pursuing significant innovations in the way we set price-quality paths;

137.2 deliver a minimal amount of performance monitoring and reporting in order to meet our statutory obligation to do so;

137.3 take a more reactive approach to our compliance and enforcement work; and

137.4 be unable to undertake consumer outreach, instead relying solely on formal consultation processes that smaller stakeholders may be less well equipped to participate in.

138. The main benefits of the 'no new funding' approach over 'bridging the gap' are:

138.1 industry levies would be lower than they would be under 'bridging the gap'; and

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12 This is calculated using the remaining funding within the current multi-year appropriation (MYA) and assumes a roll-over of the current MYA to the next 5 years at the same level.

138.2 the regulatory burden on regulated businesses would likely reduce in the short term, as, beyond price-quality path resets, there would be little that we would be consulting on.

139. The main costs of the 'no new funding' option are:

139.1 price-quality resets would be confined to the basics, without much capacity for innovation in the way we set price-quality regulation;

139.2 constraining opportunities to improve outcomes in the energy sector. In particular, we would have very limited resource to perform our performance monitoring and reporting function to improve stakeholders', and our own, understanding of the performance of regulated businesses. We would also have limited ability to influence the performance of consumer-owned energy businesses, for whom information disclosure is the only form of regulation under Part 4;

139.3 not meeting consumers' and the government's expectations for meaningful engagement with consumers; and

139.4 a more reactive approach to compliance and enforcement, which could result in the build-up of a backlog of compliance matters to investigate.

140. This option was ultimately discounted as we do not consider it meets the expectations of consumers, industry participants, or government.

Holding the line

141. Under this scenario we would aim to maintain the same outcomes in each of the performance areas described in Chapter 4 as we see today. So, where the industry is in 2020 is where we would aim to remain in 2026.

142. We would do this by:

142.1 continuing to focus primarily on rule setting, and setting and administering price-quality paths;

142.2 continuing to deliver a limited amount of performance monitoring and reporting, with a focus on monitoring profitability and limited capacity to make progress in other critical areas like understanding and challenging businesses' asset management practices; and

142.3 undertaking similar levels of consumer outreach as we have in recent years, but without the capacity to expand our consumer outreach.

143. The main benefit of 'holding the line' over 'bridging the gap' is:

143.1 industry levies would be lower than they would be under 'bridging the gap'; and

143.2 the regulatory burden on regulated businesses would likely be lower in the short term than it would be under 'bridging the gap', as we would likely be consulting on fewer matters and requesting less information from businesses.

144. The main costs of this option are:

144.1 It constrains opportunities to improve outcomes in the sector. For example, we would be unable to put in place a strong focus on building a clearer picture of regulated businesses' asset management performance and influencing improved performance in this area. Ensuring regulated businesses have sound asset management practices is critical to ensuring that networks are well placed to deliver for their consumers now and in the future.

144.2 not meeting consumers' and the government's expectations for meaningful engagement with consumers.

145. It is our assessment that under the 'holding the line scenario' it will cost $10.4M per year to deliver our energy work under Part 4. This is comprised of 35 full time equivalents and $1.1M in external costs.

146. This option was ultimately discounted as it misses some of the greatest opportunities to deal with the issues facing the sector and consumers and to make the most of our powers to use information and analysis to influence behaviour.

Bridging the gap+

147. In this scenario, we would aim for the same overall outcomes as 'bridging the gap' but at a faster rate and with the aim of becoming a best in class regulator.

148. The main benefits of the 'bridging the gap+' option over 'bridging the gap' are:

148.1 faster development of our performance monitoring work – including in the areas of asset management;

148.2 an expanded focus on understanding consumer needs, preferences and behaviour;

148.3 a greater focus on capability building within the Commission;

148.4 an increased focus on international engagement;

148.5 an increased focus on collaborating across government in relation to the broader energy regulatory system;

148.6 an increased focus on evaluating the effectiveness of our work; and

148.7 the capacity to simplify the regulatory rules through the IM review.

149. The main costs of this option are:

149.1 an increase in industry levies as compared to the 'bridging the gap' scenario; and

149.2 an increased burden on stakeholders to provide information and participate in regulatory consultations.

150. It is our assessment that under the 'bridging the gap+' scenario it will cost $13M per year to our deliver our energy work under Part 4. This is comprised of 45 full time equivalents and $1.48M in external costs.

151. We consider we should have many of the aspirations described above, and that there are real benefits in pursuing those initiatives. However, this option was ultimately discounted because:

151.1 we are conscious that it may ask too much too quickly from businesses and consumers – particularly in terms of the engagement and consultation burden. It may also be beneficial to see how the role of the Consumer Advocacy Council develops before further accelerating our consumer outreach;

151.2 we are mindful of imposing additional short-term costs on consumers in the current financial climate; and

151.3 it remains uncertain whether domestic travel will remain viable in the short to medium term, and international collaboration remains restricted due to the varying impacts of COVID-19 in other countries.

Question 9

Please provide feedback on whether you think one of the other funding options set out above is more appropriate than our preferred option of 'bridging the gap', and why.

Attachment A: Overview of our regulatory responsibilities

152. In this chapter we provide an overview of our regulatory responsibilities under Part 4 as it applies to electricity and gas networks.

Setting and administering price-quality regulation

153. For businesses subject to price-quality regulation, we set maximum revenues that they can recover from consumers and minimum quality standards they must meet.

154. Every five years, we are required to:

154.1 set default price-quality paths for over half of the country's 29 electricity distribution businesses;

154.2 set an individual price-quality path for Transpower; and

154.3 set default price-quality paths for gas pipeline businesses.

155. From time to time, we must also consider applications for customised price-quality paths from those electricity distribution and gas pipeline businesses that apply. Our costs associated with assessing these proposals are largely met by the regulated business making the application, and so are not covered by this funding proposal.

156. The price-quality paths also require ongoing administration. For example:

156.1 assessing applications to reopen the price-quality paths. For example, an electricity distributor may apply to us for an increase to its revenue allowance to meet the costs of large distributed generation and large unforeseen industrial connections, such as due to the electrification of process heat; and

156.2 assessing applications from Transpower for additional revenue to deliver certain capital expenditure projects. For example, where major capital expenditure is required to upgrade the national grid.

Maintaining the information disclosure requirements and input methodologies

157. To ensure that the information disclosure requirements and input methodologies remain fit for purpose, they need to be amended from time to time.

158. In the case of the input methodologies, which are the rules, processes and requirements that underpin Part 4 regulation, we are required to review them at least every seven years. This is a significant undertaking, which we are required to next complete before the end of 2023. Our current level of funding does not allow for this.

Performance monitoring and reporting

159. We regulate the performance of businesses covered by Part 4, including by analysing the information they disclose under the information disclosure

requirements we set. By shining a light on the performance of regulated businesses, we can incentivise them to act in the long-term interests of their consumers.

160. For example, through our performance analysis function, we are able to monitor risks to network reliability and resilience and report on other areas of performance that stakeholders are interested in, such as innovation and efficiency.

Compliance and enforcement

161. Under Part 4, we monitor compliance with the information disclosure requirements, price paths and quality standards we set. Where these requirements are contravened, we have a range of enforcement options available, including seeking pecuniary penalties in court.

Outreach and engagement

162. We supplement the use of our other tools through other activities such as outreach and consumer and stakeholder engagement. Effective use of these tools is critical to being an effective, modern regulator.

Attachment B: Resourcing breakdown

163. As an economic regulator we must apply best practice principles to be transparent, accountable, targeted, proportionate, and consistent in all facets of our work from incentive setting to enforcement to information gathering.

164. To do this we need the right skills, expertise and interactions with a wide range of stakeholders who have an interest in the sector.

165. To ensure we remain relevant and effective in our role the form and style of regulation needs to be increasingly dynamic to respond to changes within and across sectors because of new technology or consumer behaviour and availability and accessibility of data and information.

166. Economic regulation now involves more than examining investment in and access to infrastructure. Regulators increasingly need skills in data analysis, outreach and consumer engagement, and behavioural economics.

Resourcing the Part 4 regime for energy

167. Below we outline the people requirements to deliver on all obligations under Part 4 for electricity and gas under the 'bridging the gap' funding scenario.

Estimated full-time equivalents (FTEs) required for running the energy regime, excluding the review of input methodologies. We estimate that 41 FTEs would be required over the period, including:

- 1 Head of Energy, Airports and Dairy;
- 0.5 Compliance Manager;
- 4 managers;
- 2 project managers;
- 2 principal advisers;
- 1 principal investigator;
- 1 staff member to provide administrative support;
- 3.2 economists;
- 4.3 legal advisers;
- 4 compliance staff;
- 2 outreach and engagement specialists; and

- 16 analytical staff members including chief advisers/senior analysts/analysts/assistant analysts.

A team of 13.5 FTEs to run the review of input methodologies over a two-year period. This could be made up of:

- 1 Manager;
- 1 Principal Adviser;
- 1.5 Project Managers;
- 2 legal advisers;
- 1 economist; and
- 7 analytical staff members including chief advisers/analysts.

168. Staff would be supported by external economic and legal advice as needed, and by wider internal and external technical expertise across the Commission.

Attachment C: Consultation Questions

169. We are interested in your feedback on the funding proposals above.

170. We are also interested in your views about the relative priority we should give to different regulatory activities anticipated under the funding proposals. We would appreciate your feedback on the following questions to help us review and refine our view of future funding requirements for regulating the energy sector. The questions are included where relevant in the consultation paper above but are summarised below for reference.

Introduction	
Question 1	Do you have any feedback on the purpose and objectives of this consultation paper?
Question 2	Please provide feedback on whether you agree with how we have characterised the operating context of our work – in terms of a regulatory regime with increased expectations – in relation to our regulation of electricity and gas networks.
Chapter 2: The changing energy landscape	
Question 3	Please provide feedback on whether you agree with how we have characterised the changing energy landscape in relation to electricity and gas networks. Are there other sector factors that you think are important?
Chapter 3: Increased expectations of the Commission	
Question 4	Please provide feedback on whether you agree with how we have characterised the increased expectations on the Commission.
Chapter 4: Delivering consumer outcomes in electricity and gas networks	
Question 5	Please provide feedback on how we have characterised our approach to delivering consumer outcomes in electricity and gas networks and our focus on 'bridging the gap'. Are there other outcomes you would expect to see with the additional funding we are seeking in the consultation document?
Chapter 5: Implied workplan and costing for our energy work	
Question 6	Please provide feedback on the workplan for 'bridging the gap' outlined above in relation to electricity and gas networks. Are there other elements of the workplan that should be included?

Chapter 6: Implied workplan and costing for the IM review	
Question 7	Please provide feedback on the workplan for 'bridging the gap' outlined above in relation to the IM review. Are there other elements of the workplan that should be included? Do you agree that the 'bridging the gap' scenario for the IM review is more appropriate than 'bridging the gap+'?
Chapter 7: Reasonableness checks	
Question 8	Please provide feedback on whether you think the additional funding we are seeking for our work in relation to electricity and gas networks is appropriate. If you think a different level of funding is warranted, please explain why.
Chapter 8: Other options we considered	
Question 9	Please provide feedback on whether you think one of the other funding options set out above is more appropriate than our preferred option of 'bridging the gap', and why.

Attachment D: Our current funding structure

171. Overall the Commission is funded from eight appropriations across our regulatory, competition and consumer work (including litigation funding). The revenue for these appropriations is derived from a mixture of Crown funding (general taxes), levies on regulated industries, interest revenue, determination applications and cost recoveries.

172. Our regulation work is primarily funded through the appropriations shown below, with our work under Part 4 of the Commerce Act 1986 funded by three multi-year appropriations (MYA), each for a 5-year period (2019/20 being the first year of the next 5-year period).

Sector	Appropriation type	Cap (Annual or MYA) ($m)
Telecommunications	Annual	6.000
Fibre (and Broadcasting)	Multi-year appropriation (4-year: 2018/19 – 2021/22)	12.300
Electricity lines services	Multi-year appropriation (5-year: 2019/20 – 2023/24)	28.311
Gas pipeline services	Multi-year appropriation (5-year: 2019/20 – 2023/24)	9.684
Specified airport services	Multi-year appropriation (5-year: 2019/20 – 2023/24)	2.763
Dairy	Annual	0.757
Fuel	Annual – one-off amount for the 2019/20 year for preparatory work relating to the Fuel Industry Act 2020 (Part of a Multi-Category Appropriation which includes the Competition and Consumer categories)	0.500

173. Our work on electricity, gas, and airports under Part 4 is currently funded over a five-year period in three appropriations as shown above. We are not seeking any additional funding for the airports appropriation and we are discussing separately with government funding for the new fuel regulatory regime expected to start in 2021.