

20 December 2021

Competition and Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
Wellington 6140

Vector Limited
101 Carlton Gore Rd
PO BOX 99882
Auckland 1149
New Zealand
+64 9 978 7788 / vector.co.nz

By email: economicregulation@mbie.govt.nz

Economic Regulation and Consumer Protection for Three Waters Services in New Zealand

This is Vector Ltd's (Vector) submission on the Ministry of Business, Innovation & Employment's (MBIE) consultation on economic regulation and consumer protection for three waters services in New Zealand (the consultation).

Vector is New Zealand's largest distributor of electricity and gas, owning and operating networks which span the Auckland region. Our electricity distribution business (EDB) and gas distribution business (GDB) have been subject to economic regulation since its introduction in New Zealand.

While we do not have a direct interest in the three waters sector, we hope sharing our experience of economic regulation under Part 4 of the Commerce Act will assist MBIE in developing an appropriate and effective economic regulation framework for the three waters. We are also interested in the overall direction of travel for economic regulation in New Zealand.

In this submission, we therefore (1) query whether Part 4 economic regulation in the energy sector remains fit for purpose and (2) provide some observations on MBIE's discussion paper for three waters, based on Vector's experience as a regulated entity.

It is necessary to establish whether economic regulation in the energy sector remains fit for purpose

The operating environment for EDBs and GDBs has changed significantly since the Part 4 regulatory regime was implemented. Rapid technological change and decarbonisation driving increased electrification has called into question whether the current framework is fit for purpose.

Part 4 was designed during a time of relative predictability in the energy sector, where it was considered the interests of consumers were best served by a passive 'set and forget' regime based on past performance and targeting incremental efficiency gains.

The focus of the regime is similarly narrow: the regime does not consider the impact of an investment decision on the overall system or the end consumer's bill. Instead, decisions are made in strict market silos (i.e. separately for generation, transmission and distribution).

In our view, it is necessary to consider whether Part 4 needs to be redesigned to ensure government, regulation and industry can deliver the transformation of the energy sector at lowest cost to consumers. To use an analogy: it is unlikely today's Ultra-Fast Broadband network would have been delivered by copper regulation in the telecommunications sector.

We encourage MBIE and the Commerce Commission (Commission) to work with stakeholders to establish how economic regulation of the energy sector can best support New Zealand's transition net zero. We consider this needs to be done with urgency.

Economic regulation of three waters

Our response to specific consultation questions is provided in the table below. As a general comment, given our concerns about whether Part 4 remains fit for purpose, we would encourage MBIE to exercise caution before using it as a model for the economic regulation of three waters.

We would welcome the opportunity to discuss any issues raised in our submission.

Vector's contact person for this submission is:

Imogen Welling
 Regulatory Specialist
Imogen.Welling@vector.co.nz

Appendix one: response to consultation questions

Topic	Vector response
Form of regulation	<p>We encourage MBIE to also consider broader forms of regulation beyond the traditional approaches of default and individual price-quality paths.</p> <p>For example, propose and respond models provide regulated entities more opportunities to engage with the regulator to establish price paths that reflect their particular circumstances and consumer requirements.</p> <p>The state of Victoria's PREMO (Performance, Risk, Engagement, Management) water pricing framework is an example. The PREMO framework still uses building blocks to determine revenue requirements, however, a greater emphasis is placed on consumer engagement in pricing proposals and return on equity is linked to the tangible outcomes delivered to consumers.</p> <p>An independent review into PREMO commissioned by the Victorian Essential Services Commission in 2018 found strong evidence it was contributing to significantly better outcomes for customers.</p> <p>There appear to be good reasons to consider an alternative model to the traditional price-quality paths under Part 4. For example, Vector understands that the water entities will be statutory bodies with statutory objectives, which extend to areas not currently contemplated by the traditional price-quality path framework, e.g. sustainability and Te Mana o te Wai considerations. Vector sees some parallels between three waters and the energy sector today, where there is no longer a one dimensional focus on low-cost / no excessive profits, but instead new (and important) objectives, such as decarbonisation and technological change. Vector also sees merit in having a more flexible regulatory approach which takes into account consumer feedback in the electricity sector, given the additional priorities identified since the introduction of the Part 4 regime.</p> <p>More broadly, Vector understands that one of the main issues that economic regulation would seek to address in the water sector is significant underinvestment. MBIE may wish to consider whether price-quality path is the appropriate tool to achieve this, given, in Vector's experience, the price-quality path strictly controls investment which may not be desirable in the water context (at least initially).</p>

<p>Most suitable body to be the economic regulator</p>	<p>If the water regulator and the economic regulator are separate entities care will need to be taken to avoid potential gaps and duplication in the regulatory frameworks. This would increase regulatory costs and increases the risk of regulators inadvertently imposing conflicting obligations. Having a single regulator for the sector (for example, Taumata Arowai) would avoid these risks and make it easier for government policy for the sector to be implemented coherently.</p> <p>In the electricity sector, EDBs are regulated by the Electricity Authority along with price-quality regulation by the Commission. However, these regulators are not always aligned. In addition, the <i>Electricity Industry Amendment Bill</i> proposes to duplicate regulatory responsibilities in some areas. For example, the Bill proposes to provide the Electricity Authority powers to regulate distribution quality standards, while the Commission already sets quality standards for distribution under the Part 4 regime. This creates a real risk of the Electricity Authority setting quality standards that are not reasonably achievable within the expenditure levels set by the Commission.</p> <p>If the Commission is the economic regulator for water, it will be important to ensure they are appropriately resourced so other regulated businesses such as EDBs and GDBs still receive appropriate focus.</p>
<p>Statutory objective of economic regulation</p>	<p>The ability of the regulator to take into account objectives beyond those set out in the purpose statement - in particular decarbonisation - in making regulation under Part 4 is currently a live issue in the energy sector.</p> <p>We consider the Commission is empowered to take into account factors beyond those set out in s52A (1)(a)-(d) - specifically decarbonisation objectives. That is, we consider the focus of s52A is the long term benefit of consumers consistent with workable competition, rather than limiting the desired outcomes to those listed in s52A(1)-(d). In terms of decarbonisation, s5ZN of the <i>Climate Change Response Act</i> additionally empowers bodies performing a public function to take account of the net zero target.</p> <p>If there is a risk that this interpretation is not accepted, then legislation needs to be changed urgently to allow the Commission to take New Zealand's net zero into account when making decisions under Part 4.</p> <p>Similarly, to avoid these issues in the water sector, we would be hesitant to rely on the Part 4 purpose statement and instead consider that there would be value in making such outcomes explicit in separate legislation which establishes the economic regulation framework. Otherwise, there is a risk that water entities will not be funded to deliver the outcomes consumers want.</p>
<p>Efficiency challenges</p>	<p>The consultation paper suggests a preference for 'active efficiency' such as comparative efficiency benchmarking through econometric techniques.</p> <p>We note the Part 4 regime prohibits the regulator from using comparative efficiency benchmarking to set starting prices, rates of change, quality standards, or incentives to improve quality of supply. This is appropriate as suppliers have significantly different operating environments and consumer preferences that makes benchmarking unhelpful.</p> <p>We expect this is likely to be the case for the new water entities, particularly given these entities will be starting from different base levels of performance.</p>
<p>Consumer protection</p>	<p>We support greater emphasis on consumer preferences in stakeholder engagement and regulatory decision making.</p>

	<p>In terms of quality standards, we consider the most appropriate form of regulation is through targeted quality standards to reflect the diversity of operating environments and consumer needs across regulated suppliers.</p> <p>We support guaranteed service levels over generalised quality standards, as we consider consumer interests are better promoted by payments to the specific consumers impacted by quality breaches. However, care needs to be taken to ensure these are consistent with any general quality standards as duplicating quality standards would ultimately result in increased regulatory costs without quality improvements.</p> <p>We also support the regulator imposing incentives on high quality consumer engagement. However, this should not be a prescriptive requirement as different consumer groups - and different regulated businesses - will have different preferences as to how this engagement takes place. For example, we note that the Water Services Entities Bill (the exposure draft) requires consumer engagement on asset management plans and funding and pricing plans, but leaves the water services entities with some flexibility in how they carry out that engagement. We also encourage data analytics to compliment traditional methods of consumer engagement.</p>
Government policy statements	<p>We agree it would be useful to provide high level strategic direction to the new Water Services Entities to inform and guide the entities' decisions and actions in fulfilling their statutory purpose and objectives.</p> <p>We consider this will also be useful for the regulator to provide confidence to implement government policy that is not directly included in the regulators statutory purpose.</p>
Merits review	<p>We agree it is appropriate to allow merits review on decisions that impact specific regulated suppliers: i.e. on input methodologies. It may also be appropriate to allow general rights of appeal of price-quality path decisions (if it is ultimately determined that price-quality regulation is appropriate in the water context).</p>