



COMPETITION REGULATORY SYSTEM ASSESSMENT

Part A - Summary of Competition Regulatory System Assessment

Context

1. MBIE has primary responsibility for designing and overseeing a large number of regulatory systems. A regulatory system includes the rules, institutions, skilled workforce, practices and understandings which combine to make regulation of an activity or sector effective.
2. The State Sector Act was amended in 2013 to make it clear that Departmental Chief Executives have regulatory stewardship responsibilities. Taking a stewardship approach requires Chief Executives to look beyond their direct statutory responsibilities to the capability and resilience of the regulatory system over time, including the other agencies which form part of the system as well as MBIE.
3. The principal reason that MBIE has developed a regulatory systems programme is to discharge these stewardship responsibilities well. MBIE is also very aware that the regulatory systems it is responsible include three where major failures have occurred in NZ- building (leaky buildings), financial markets (finance companies) and health and safety at work (Pike River) and this history emphasises the importance of continuous monitoring and improvement of regulatory systems. Looking systematically across different regulatory systems also enables MBIE to transfer learning and innovation from one system to others more readily.
4. One of the tools MBIE is using to be an effective steward of its regulatory systems is a periodic assessment of each system. These assessments are a snapshot rather than an in depth analysis. The assessments check how the system is working now rather than what the rules should be (ie they're not policy reviews), and they look to identify the main areas which should be the focus of MBIE's attention in the next little while rather than be more in depth analyses of the strengths and weaknesses of an institution (ie they're not Performance Improvement Framework reviews).

The Competition Regulatory System

5. The Commerce Act 1986 forms the core of the competition regulatory system. The Commerce Act is supplemented by a number of sector specific schemes or policy approaches that provide regulation targeted at specific market issues. The current assessment has considered how the general competition system, centred on the Commerce Act, works with the sector specific regimes for energy markets. These bespoke regimes are found in the Electricity Industry Act 2010 and the Gas Act 1992.
6. The Commerce Act's objective or purpose is 'to promote competition in markets for the long-term benefit of consumers within New Zealand'. This objective applies to the set of



generic competition rules that are enforced by the Commerce Commission. These rules aim to restrict anti-competitive conduct, arrangements and mergers.

7. The Electricity Industry Act's objective is to 'to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers'. The Electricity Authority is the regulator.
8. The stated purposes of the Gas Act do not expressly refer to competition. Part 4A of the Act provides for the co-regulation of the gas industry by the Government and an industry body. The industry body currently approved for that purpose is the Gas Industry Company Limited. The industry body recommends gas governance regulations to the Minister on the wholesale market, processing facilities, transmission and distribution. Competition features in the objectives of the industry body in recommending gas governance regulations. The industry body's primary objective is to ensure that gas is delivered to existing and new customers in a safe, efficient, and reliable manner.

The Assessment Process

9. An assessment of the competition regulatory system was carried out in 2015 by a panel comprising Adrienne Meikle (Chair), General Manager Resolution Services; Shane Kinley, Policy Director Labour Environment and at the time responsible for the regulatory systems programme; Mark Vink, Principal Advisor and Ben Temple, Senior Analyst, both from the Treasury, as alternates; and Julie Nind, Principal Advisor, Trade and Regulatory Cooperation (Lead report writer).
10. The panel conducted a series of interviews from mid-March through to late April 2015. Those interviewed included the Ministry of Business, Innovation and Employment (MBIE) policy staff from the then Labour and Commercial Environment Group (responsible for competition law and policy) and the then Infrastructure and Resource Markets Group (responsible for energy regulation). The panel held a workshop with staff from the competition team in the Labour and Commercial Environment Group. The panel also met with each of the regulators on several occasions. This included testing with them themes and issues that emerged from the interview process.
11. The scope of the competition regulatory system meant it was important to hear from those with experience of the different parts of the system, including economic regulation under Part 4 of the Commerce Act, energy regulation, and the general competition rules. The panel extended its initial list of interviewees, based on input from the regulators, and also extended the assessment timeframe to ensure it heard from a sufficient cross-section of participants.
12. The panel interviewed 23 external parties, including regulated parties, other system participants and expert advisors, to ensure a wide range of view-points and experience were represented.



13. The panel had expected that external parties might find it difficult to understand the purpose of the regulatory assessment and to distinguish it from a policy review. The panel found regulated parties were generally able to separate concerns with particular regulatory decisions from their views on the functioning of the system. The panel did not end up in substantive policy discussions, although policy issues were sometimes used to illustrate points being made.
14. The panel greatly appreciates the input of these people who freely gave up their time to assist it. The panel also appreciated the free and frank nature of the discussions. It would not have been possible to properly assess the system without their input.
15. Regulatory system assessments are conducted over a short time frame and are necessarily limited in their scope. The panel did test emerging issues and questions from the interviews with the system owners, policy staff and regulators. The panel also tested views expressed in some interviews with others. It did this to confirm whether there was sufficient agreement among system participants about the main strengths and weaknesses of the system for the panel to use them as a basis for its findings.

The Key Findings

16. The overall consensus of those interviewed and, as a consequence, the view of the panel is that the competition regulatory system is generally functioning well. The assessment did not reveal any significant system failures.
17. There is a widespread view that in recent years there have been substantial improvements in the performance of the regulators and the policy framework in relation to competition. The regulators were generally seen by many as exemplars in the processes and approaches that they use to deliver on the system's objective and expectations (even where parties disagreed with the policy settings or the substantive decisions of a regulator). There are lessons for other systems in the dedicated emphasis placed on communication and transparency by the two primary regulators.
18. The system is set up to focus on meeting its objective of promoting competition in markets for the long term benefit of consumers. However, it is not always easy to assess how well the system is actually achieving that objective.
19. There are also areas which may warrant further attention to ensure the system:
 - can clearly articulate an overall story of why competition is important and how consumers benefit from the operation of the system,
 - continues to function well,
 - improves its ability to deliver on the primary system objective of promoting competition to deliver long term benefits to consumers,



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- ensures that the consumer voice is effectively incorporated into system processes, and
 - can better measure its performance against achieving policy objectives.

20. Many of these issues are likely to surface through, and will be addressed in, the various policy reviews that are planned or already underway.

Specific findings

21. The panel made the following specific findings:

- The public and system participants would benefit from a contemporary competition story.
- Regulator performance is generally improving but MBIE needs to show stronger leadership.
- There appear to be person dependency risks for the system, both within MBIE and also for the regulators.
- Some stakeholders observed differences between the electricity and gas regulatory models.
- More needs to be done to get a consumer perspective into relevant parts of the competition system.
- There needs to be a focus on competition policy, not just the competition regulatory system.
- There needs to be a more strategic approach to barriers to competition generally and on sector specific issues.
- Regulators, as independent crown entities, should be able to engage in public debate on a “no surprises” basis where they judge it appropriate.
- There is scope to improve performance measures for the system and to refine one performance measure for the Commission.
- The system is complex and MBIE should consider whether any of that complexity can be reduced.



Part B - Summary of the System Owner Response

22. The system owners welcome the panel’s final report. It provides a constructive and useful addition to our ongoing stewardship activities.
23. The overall findings have a close alignment with the feedback we receive from stakeholders. Measuring the impact of the competition system on macro measures of consumer welfare is recognised internationally as being an extremely difficult area of empirical analysis. Where empirical studies have been able to measure the impact of competition policy on productivity (as a proxy/driver of long term welfare) in OECD countries with similar competition policy settings to New Zealand, they find a positive and significant impact¹. Such studies generally find that the impact of competition policy is difficult to disentangle from the quality of a jurisdiction’s institutions and the impact of economic geography. MBIE’s ongoing evaluative activity will explore the feasibility of conducting similar empirical analysis using New Zealand data, including whether it is feasible to analyse the major elements of the competition regulatory system separately.
24. The specific findings of the review and the systems owners’ response is set out in the following table:

<i>Finding</i>	<i>System Owner Response</i>
The public and system participants would benefit from a contemporary competition story for the general competition part of the system	<i>Agree. A contemporary competition story will be incorporated into a regulatory charter² for the Commerce Act that will be developed through 2016. The system owners and regulators also will look for opportunities to incorporate relevant elements of the contemporary competition story into accountability documents and other relevant publications.</i>
Regulator performance is generally improving but MBIE needs to show stronger leadership	<i>Agree – the system owners agree with the panel’s assessment that regulator performance has improved over time, and that the Commerce Commission and Electricity Authority are generally seen as exemplar regulators.</i> <i>MBIE actively looks for opportunities to demonstrate leadership in the competition system. An example of this is MBIE’s collaboration with industry in establishing the NZ Smart Grid Forum to facilitate dialogue about future challenges and opportunities for the electricity sector presented by disruptive technologies.</i>
Some stakeholders observed there are differences between the electricity and	<i>Agree – MBIE is very aware of the different institutional arrangements in the electricity and gas sectors, but does not consider that consistency between the gas and electricity</i>

¹ See for example Buccirossi et al, (2013). ‘Competition Policy and Productivity Growth: An Empirical Assessment’, *Review of Economics and Statistics*, Vol. 95, No. 4, Pages 1324-1336.

² A regulatory charter can be thought of as a statement of intent for a regulatory regime. It would normally set out the policy objectives, roles and responsibilities and ongoing monitoring and evaluation activities for a regulatory system. It is intended that the regulatory charter would be publically available.



gas regulatory models	<i>regulatory models should be pursued for its own sake. Rather, any consideration of the GIC model (established more than ten years ago) should be driven by a clearly identified case to improve regulatory performance and relevant policy outcomes.</i>
Key person risks in MBIE and the regulators need to be managed	<i>Agree. MBIE has acknowledged this risk as part of its risk management approach and has put in place knowledge sharing and mentoring arrangements to reduce this risk over time. As a result, policy reviews and evaluative activity are being led by a wide range of MBIE staff. Both the Commerce Commission and the Electricity Authority recognise this issue and have put in place strategies for actively managing succession planning, talent management, and recruitment to manage this area of risk.</i>
More needs to be done to get a consumer perspective into relevant parts of the competition system	<i>Agree – this has been identified as an issue through current evaluative activity and will be explored further in a policy project that will commence in Quarter 2 of 2016.</i>
There needs to be a focus on competition policy, not just the competition regulatory system	<p><i>Strongly agree. Numerous markets in New Zealand are characterised by high levels of firm concentration and structural features that may serve to limit competition. While MBIE will continue to fulfil its maintenance and stewardship obligations for the competition regulatory system, the scope for long term benefits to consumers from system policy improvements are likely to be limited in comparison to the scope for change in New Zealand’s broader competition policy settings. A recent example of our increased focus on broader competition policy work is the Residential Construction Market Study.</i></p> <p><i>MBIE has recently renamed the Competition and Consumer Law team to the Competition and Consumer Policy team to reflect that the team plays an important role in competition policy across government. The links between competition policy and telecommunications policy have also been recognised through the creation of a new Commerce, Consumers and Communications (CCC) branch.</i></p>
There needs to be a more strategic approach to barriers to competition generally and on sector specific issues	<i>Strongly agree. Many of New Zealand’s barriers to competition are the subject of historical events, trade-offs against other policy objectives, or strong vested interests. MBIE has undertaken an environmental scan of the New Zealand economy to identify barriers to competition in the New Zealand economy. Building off this work, we have been working with the Minister of Commerce and Consumer Affairs and the Minister for Economic Development to bring a stronger competition policy flavour to the Business Growth Agenda (BGA) with particular focus on removing regulatory and institutional barriers to competition that sit outside the core competition regulatory system.</i>



Regulators should be able to engage in public debate on a “no surprises” basis where they judge it appropriate	<i>Agree.</i>
There is scope to improve performance measures for the system and to refine one performance measure for the Commission	<i>Agree. MBIE and the Commerce Commission have initiated work to review the Commerce Commission’s performance measures. Work is also underway on the wider evaluation programme for key aspects of the system which will be set out in the regulatory charter for the Commerce Act.</i>
The system is complex and MBIE should consider whether any of that complexity can be reduced, particularly in relation to Part 4 of the Commerce Act	<i>Agree. Key factors driving the perception of complexity in Part 4 in the Act include the:</i> <ul style="list-style-type: none"><i>• move to specify upfront input methodologies (to promote investment certainty) combined with the subjection of these methodologies to merits review in the High Court has increased both the robustness and complexity of these key components of building blocks regulation;</i><i>• desire to promote investment certainty while being flexible enough to deal with a large number of regulated suppliers in different markets, in different financial positions, and with different ownership and institutional structures (e.g. the interaction of default and customised price-quality regulation).</i> <i>As part of its review of input methodologies, the Commerce Commission has a specific work stream to explore opportunities to reduce the complexity of the current input methodologies.</i>

25. The system owners thank the panel and stakeholders for their input into the competition regulatory system review. Its findings are thoughtful, balanced, and accurately reflect the complexity of the system and the different views held by stakeholders and other parties who have regular interactions with the competition regulatory system. The review’s findings will provide a highly useful input into the future stewardship, evaluative, and maintenance work on the competition regulatory system.