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Dear Paul and Gael

Submission on Switching Arrangements for the New Zealand Gas Industry, Part 1 and Part 2

Introduction

1. Thank you for the opportunity to make a submission on the Gas Industry Company's (GIC's) consultation papers "Switching Arrangements for the New Zealand Gas Industry, Part 1 and Part 2" dated 31 August 2006 (Switching Paper and Compliance Paper).
2. Mighty River Power supports both:
 - a. the proposed Gas Governance Rules (Switching Rules); and
 - b. the proposed Gas Governance Regulations (Compliance Regulations).
3. We applaud the GIC for the good work it has done on these matters in coming to a workable solution. The process has been in the most part robust and considered with the GIC releasing 4 discussion papers¹ and holding a number of Industry Participant Workshops. We consider that the GIC's considered consultative approach bodes well for the future of the co-regulatory model.
4. However, we are concerned that section 43G(2)(c) Gas Act poses a difficulty for the proposed Switching Rules and Compliance Regulations as they presently stand (as identified by the GIC). In our view, section 43G(2)(c) of the Gas Act is unambiguous in its application to gas retailers to the exclusion of distributors and meter owners. Accordingly, we consider that the section will have to be amended to include distributors and meter owners to ensure the integrity of the proposed Switching Rules and Compliance Regulations. We discuss this matter further below.

¹ Alternative ways to improve current switching arrangements; cost benefit analysis of those alternatives; mechanisms to implement the preferred approach; and compliance and enforcement arrangements in the New Zealand Gas Industry.

5. No part of this submission is confidential and we are happy for our submission to be made publicly available.

The Switching Rules

Q1. Does Mighty River Power agree with the regulatory objective?

6. Mighty River agrees that the direct objective of the Switching Rules is to achieve the timely and accurate switching of customers between retailers and distributors. However, the key objectives of the Switching Rules are best described in relation to how the Switching Rules contribute to the regulatory objectives contained in section 43ZN Gas Act.² These include the objectives of:
 - a. Ensuring that gas is delivered to existing customers in, among other things, an efficient manner [section 43ZN(a) and GPS 4]; and
 - b. Barriers to competition in the gas industry are minimised (to the long term benefit of end-users) [section 43ZN(b)(ii) and the GPS 5(c)].

Q2. Do submitters agree with the analysis of the proposal?

7. Yes.

Q3 Do submitters agree the proposal complies with section 43N of the Gas Act?

8. Yes, with the caveat that section 43G(2)(c) should be amended to explicitly include reference to distributors and meter owners.

Q5 Do submitters have any other information that they consider is relevant to the assessment of the proposal?

9. Mighty River Power agrees with the GIC that section 43G(2)(c) poses a difficulty for the proposed Switching Rules and Compliance Regulations as they presently stand. Section 43G(2)(c) is expressly directed at switching arrangements and the ability of customers to choose a preferred gas retailer. The section provides that the Governor-General in Council may make regulations:

Requiring all **gas retailers** to comply with, and give effect to, a system or set of rules that will enable any customer to choose, and alternate, between competing gas retailers, with the objective of promoting competition in gas retail market. (emphasis added)

10. The above provision provides that the set of Rules to enable switching are to be directed at gas retailers. In our view, application of the principles of statutory interpretation (plain English rule; and the rule *expressio unius est exclusio alterius*, to express one thing is to exclude another) results in an interpretation of the provision that does not include

² Objectives of industry body in relation to recommendations for gas governance regulations

distributors and meter owners. We consider the omission of these terms to be a drafting error. For section 43G(2)(c) and the Switching Rules to work they must apply equally to retailers, distributors and meter owners.

11. Accordingly, in Mighty River Power's view, section 43G(2)(c) should be amended to include reference to distributors and meter owners. If section 43G(2)(c) is not amended, there is a real risk that the Switching Rules and Compliance Regulations will be ultra vires.
12. We note that typically Mighty River Power would be strongly against amending an Act for the purpose of ensuring that a proposed regulation is intra vires. However, in the present case we strongly consider that section 43G(2)(c) is in essence a drafting mistake and that the Switching Rules and Compliance Regulations as they stand are consistent with the objectives of the Gas Act.
13. In an unrelated matter, we note that reference to Rule 35 in Rule 33.1 should be to Rule 38.

Q5 Do submitters agree that the proposal meets the Regulatory Objective?

14. We agree the regulatory proposal meets the Regulatory Objective as stated by the GIC of facilitating the timely and accurate switching of customers between retailers and distributors. We also consider that the regulatory proposal meets the broader regulatory objective of:
 - a. Ensuring that gas is delivered to existing customers in, among other things, an efficient manner (section 43ZN(a) and GPS 4); and
 - b. Barriers to competition in the gas industry are minimised (to the long term benefit of end-users) (section 43ZN(b)(ii) and the GPS 5(c)).
15. In respect to the broader regulatory objectives above, Mighty River Power agrees with the GIC that the gas customer switching proposal will result in:
 - a. a positive net consumer benefit;³
 - b. improvement of customer satisfaction by implementing an efficient, timely and accurate switch process;
 - c. the lowering of barriers to competition; and
 - d. a reduction of administrative inefficiencies and costs.

Q6. Do submitters agree with the benefits relative to the costs of the Proposal as set out in Appendix 2?

³ Switching Paper, Appendix 2.

16. Mighty River Power has some concerns about the methodology used by the GIC to assess dynamic efficiency. The methodology is based on relative retail margins of electricity and gas.
17. There is a long distance between retail margins and dynamic efficiency. Retail margins are at best a crude proxy for the level of competitiveness of an industry. All things being equal, the greater the margin the less competitive the market will be. In turn, the less competitive the industry the greater the potential dynamic efficiency gains from promoting competition. In-of-themselves retail margins give no indication of the absolute level of dynamic efficiency gains to be had.
18. Retail margins are more tightly linked to allocative efficiency gains, in that the greater the margin (above marginal cost) the worse the allocative efficiency losses will be. A quantification of efficiency based on retail margins will consequently (at best) provide information on allocative efficiency, not dynamic efficiency.
19. The GIC states:⁴

" that reduction in retail margin is not an absolute measure of economic efficiency gains, as increased competitive pressure may simply lead to decreased profit rather than increased efficiency".
20. The above statement is imprecise, in that:
 - Improved efficiency in-of-itself does not mean retail margins are reduced - if costs go down and prices remain static, retail margins remain unchanged. The comment seems to incorrectly treat retail margins as being equivalent to retail prices; that is, a reduction in retail margin equates to a reduction in retail prices.
 - A reduction in retail margins (and prices) due to a reduction in monopoly profits will also improve allocative efficiency (contrary to the GIC's comment); the extent of which depends on the elasticity of demand.

The Compliance Regulations

21. Mighty River Power strongly supports the Compliance Regulations focus on corrective actions as opposed to a "breach and fines" regime. In this respect we are eager to see that the regime focuses on achieving the objective of enforcing compliance with the Switching Rules in a manner that keeps the focus on:
 - a. improving switching processes;
 - b. benefits to consumers; and
 - c. is least burdensome and distracting for Industry Participants.

⁴ Abid, Appendix 2 at paragraph 11.40.

22. Accordingly, Mighty River Power's support for the Compliance Regulations is conditional on the focus remaining on process rather than penalty.

Q.1 Do submitters agree with the Regulatory Objective

23. Mighty River Power agrees that the direct objective of the Compliance Regulations is to provide a high degree of confidence that the proposed Switching Rules will be adhered to, and thereby contribute to the better achievement of the Government's policy objectives for the retail sector of the gas industry.

24. However, as with the Switching Rules, the key objectives of the Compliance Regulations are best described in relation to how the Compliance Regulations will contribute to the regulatory objectives contained in section 43ZN Gas Act.⁵

25. It is critical that the Compliance Regulations are assessed in the context of the above objectives. In our view the objectives of efficiency and promoting competition for the benefit of consumers support a focus on corrective actions rather than recriminations and penalties. We consider the Compliance Regulation's focus on materiality and settlement is fundamental to achieving these objectives.

Q2. Do the submitters agree with the analysis of the Proposal?; Q3. Do submitters agree that the Proposal complies with section 43N of the Gas Act?; Q4 Do submitters have any other information that they consider is relevant to the assessment of the Proposal?

26. Mighty River Power agrees with the analysis in the Compliance Paper Statement of Proposal (Compliance Proposal) and that the Compliance Proposal complies with section 43N of the Gas Act; our only caveat is that section 43G(2)(c) needs to be amended to include distributors and meter owners (as described above).

27. In respect to questions 5, 6, 7 and 8, Mighty River Power agrees that:

- a. The benefits relative to the costs of the Compliance Proposal are likely to be superior to a voluntary compliance and enforcement regime;
- b. The Compliance Proposal will likely lead to a higher level of compliance than a voluntary compliance and enforcement regime; and
- c. The benefits relative to the costs of the Compliance Proposal are likely to be superior to alternative designs cited by the GIC in section 7 of its Compliance Proposal; and
- d. The Compliance Proposal meets the Regulatory Objective of providing a high degree of confidence that the proposed Switching Rules will be adhered to, and thereby

⁵ Objectives of industry body in relation to recommendations for gas governance regulations

contribute to the better achievement of the Governments policy objectives for the retail sector of the Gas Industry.

Concluding Remarks

28. If you would like to discuss this matter directly with Mighty River Power, please do not hesitate to contact either me (on 09 308 8202 or john.gilkison@mightyriverpower.co.nz) or John Candy (on 09 580 3783 or john.Candy@mightyriverpower.co.nz).

Yours Sincerely

John Gilkison

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