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TRUSTPOWER SUBMISSION: STRATEGIC DIRECTIONS FOR MARKET DEVELOPMENT

1 Introduction

1.1.1 Thank you for the opportunity to provide a submission on the consultation relating to strategic directions being undertaken by the Electricity Authority ("Authority").

1.1.2 We agree with the Authority's intention not to set out a future blueprint of the regulatory framework. We would like to comment only on the matter of regulatory certainty and stability, which, in our opinion does not appear to have been addressed adequately in the consultation document[1].

2 Regulatory certainty and stability[2]

2.1.1 Regulators must tread a narrow path between providing stable regulatory frameworks and ensuring that those frameworks have enough flexibility to adapt to changing market conditions.

2.1.2 This is summarised well in a recent publication by Robert Baldwin, published by the Centre on Regulation in Europe[3]:

> *"On the one hand, [regulators] have to offer stability so as to allow regulated businesses to plan activities and investments without being buffeted by unnecessary uncertainties. On the other hand, they have to be responsive and malleable so that they can adapt to new market conditions,*

[1] Statements in the remainder of this submission have been extracted from Appendix B to the consultation document, titled *Strategic Directions for Market Development*. Available online at http://www.ea.govt.nz/dmsdocument/14496

[2] The remainder of this submission could be taken as our answer to Question 5 in the consultation document.

[3] Baldwin, R. (2013). *Regulatory stability and the challenges of re-regulating*. Published by the Centre on Regulation in Europe. Available online at http://www.cerre.eu/publications/regulatory-stability-and-challenges-re-regulating

encourage innovation, facilitate provider responsiveness, and offer regulatory improvements and adjustments to address any imperfections in the current regime."

2.1.3 We are sympathetic to the Authority's predicament in having to strike the appropriate balance between stability and flexibility. We agree with the Authority in its statements in Appendix B that "*market arrangements should not impede innovation*" (p.10) and "*regulatory arrangements (for example, Code and service provider agreements and systems) should not pose undue compliance barriers to adoption of new technology*" (p.10). We also agree that the Authority should strive to "*develop regulatory frameworks that are resilient to an uncertain future, and can support the new ideas, new technologies and new participants that are likely to arise in a more competitive and changing sector*" (p.14).

2.1.4 However, we are also glad that the Authority recognises that "*supplying electricity generally requires large investments in long-lived assets (for example, up to 50-60 years) to be ready to meet consumers' electricity requirements, whether in the next five minutes or in the next five years*" (p.5). As the Authority identifies correctly, investment in electricity generation infrastructure requires significant commitment of capital. As a long-term investor and participant in the New Zealand electricity market, TrustPower desires a regulatory framework that minimises, to the extent possible, any risk that its assets will not provide a suitable return on the capital invested. We believe also that those rules must be robust to future uncertainty.

2.1.5 One of the Authority's regulatory strategy principles listed in Appendix B is to "*strive to achieve regulatory predictability because this is particularly important when regulating high capital investment industries such as electricity*" (p.17). We could not agree more.

2.1.6 However, we do not believe that this principle has been followed particularly closely by the Authority to date. The Authority's recent proposal to modify the transmission pricing methodology (TPM) is a useful case in point. While we do not wish to add to the significant volume of material submitted on the TPM proposal already, the proposal does provide a useful illustration in this context as it:

a) was a significant departure from the status quo;

b) was not signalled to (or anticipated by) participants in advance;

c) was disconnected from the body of work that had been undertaken on the subject in the past; and

d) would result in significant wealth transfers between participants (if implemented) without provisions for any sort of transition mechanism from the status quo.

3 Recommendations

3.1.1 We therefore recommend that the Authority highlights regulatory risk as an item in its summary of challenges facing the electricity sector[4]. In future, it should place much greater emphasis on achieving regulatory stability and predictability.

3.1.2 In other jurisdictions, such as Australia, rule changes generally take a long time to be confirmed and implemented, and require approval by several different regulatory bodies. This recognises the level of commitment required by investors to maximise long-term benefits to consumers. We would see this level of rigour as a positive attribute of any regulatory system.

3.1.3 The paper by Baldwin provides some useful guidance on principles that should be followed by regulators. These cover issues around **timescales**, **tractability** and **intelligibility**. In the following list we have attempted to articulate these principles in a way that would be useful to the Authority, and would provide an improved level of confidence for market participants.

3.1.4 Importantly, it should be highlighted that a requirement for a stable regime does not necessarily preclude regulators from making material changes to the regulatory framework. As Baldwin states:

"From a tractability perspective, a regime that is 'stable', in the broader sense, is not so much one in which there are no changes as one in which the changes that occur are knowable or

[4] Note that this submission was drafted before last week's announcement on energy policy by Labour and the Greens, which only heightens the issue of regulatory risk for investors in New Zealand's power sector.

foreseeable and governable. A process of change is liable to be seen as the less unstable in so far as it can be easily planned for and managed."

3.1.5 While revision of the regulatory strategy principles is unlikely to fall within the scope of this particular consultation, we would still recommend that the Authority amends its principle f) and supplements the existing list with three further principles, as per the following:

f) strive to achieve regulatory predictability ~~because this is particularly important when regulating high capital investment industries such as electricity~~ and avoid shocks or surprise impacts on the parties being regulated;

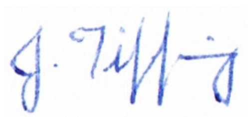
g) ensure the timescales applied to regulatory change are appropriate to the subject matter, recognising that, given the longevity and capital-intensive nature of investments in the electricity sector, a stable regime may be one that is materially unchanged for a number of years;

h) work closely with industry participants to ensure any necessary regulatory changes are knowable, foreseeable and governable; and

i) be pro-active in sharing the reasons, assumptions, calculations and policies that underlie regulatory changes so stakeholders can better understand the context and can respond appropriately to proposed changes.

3.1.6 Please feel free to contact me if you require any further information.

Yours faithfully,



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