

Review of the Electricity Authority's compliance framework

A review of the Electricity Industry
(Enforcement) Regulations 2010
Final report

27 May 2014



Executive summary

The Electricity Authority's (Authority) compliance framework is the set of regulatory arrangements under which the Authority monitors, investigates and enforces the 'rules' of the New Zealand electricity market.

The Authority has reviewed its compliance framework, starting from first principles.

This included reviewing the Electricity Governance (Enforcement) Regulations 2010 (Enforcement Regulations). The Authority will send its review of the Enforcement Regulations to the Ministry of Business, Innovation and Employment (MBIE), the government agency that administers the Enforcement Regulations.

Findings about the compliance arrangements in the Enforcement Regulations

The key findings from the Authority's review of the compliance arrangements in the Enforcement Regulations are:

- there should be less prescription in the compliance processes in Part 1 of the Enforcement Regulations
- there should be greater transparency of compliance-related activities and decisions. All information used in compliance processes should be made available unless there is good reason to withhold it
- under the settlement regime:
 - investigators should not have to always try to settle alleged breaches of the Electricity Industry Participation Code 2010 (Code)
 - the Authority should be a party to any settlement agreements and be able to enforce them
 - the Rulings Panel should be able to hear complaints about non-compliance with settlement agreements
- the Rulings Panel should not be accountable to the Authority
- Part 3 of the Enforcement Regulations (disputes and appeals) is unnecessary.

Extending the scope of the Enforcement Regulations review

The Authority has extended the scope of its Enforcement Regulations review to encompass a review of liability limits. The Authority had intended to review the liability limits for most of the market operation service providers as a separate project.¹ The scope of the separate review was to assess whether the liability limits for the certain service providers were consistent with the services provided and the balance of risk between the service providers and industry participants.

As the Enforcement Regulations contain service provider liability arrangements, the Authority decided to include the review of liability limits in its review of the Enforcement Regulations. The Authority also decided to extend the review to include liability arrangements for all market operation service providers, ancillary service agents, asset owners, and in respect of (electricity) metering standards and metering information (that is, to review all of the liability arrangements in the Enforcement Regulations).

¹ The project would assess the liability limits for the pricing manager, reconciliation manager, clearing manager, wholesale information trading system (WITS) provider, registry manager and FTR manager.

Findings about the liability arrangements in the Enforcement Regulations

The key findings from the review of the liability arrangements in the Enforcement Regulations are:

- a limit should be placed on the liability of the WITS provider for breaches of the Code where none currently exists
- annual liability limits should be put in place for metering standards and metering information
- the liability limit for the system operator should be materially increased
- the liability limit for ancillary service agents should be a percentage of revenue and not an absolute limit
- the liability limit for frequency keeping should be a little lower than for other ancillary services
- the Authority should make only relatively modest amendments to the liability limits of the other industry participants referred to in the review.

A revised set of Enforcement Regulations, which take into account the two sets of findings above, would, in the Authority's view, make the biggest single difference in achieving a best practice compliance framework. This in turn would help the Authority achieve its statutory objective.

Contents

Executive summary	ii
1 Introduction	1
2 Why did the Authority conduct this review?	2
The compliance framework review	2
What is the Authority's compliance framework?	2
The Authority's role in compliance with the Code	3
The Authority's role in compliance with the Act and regulations	4
3 How did the Authority conduct this review?	5
The Authority designed a best practice compliance framework	5
The Authority found areas for improvement in the Enforcement Regulations	5
The project includes a review of liability arrangements	6
4 How to improve the Enforcement Regulations	7
The current design of the Enforcement Regulations results from multiple 'roll-overs'	7
What the reviews found	7
5 Improving compliance arrangements	9
The compliance process is too prescriptive	9
Confidential information should be the exception rather than the rule	10
The existing settlement process	11
Settlements should not be compulsory	11
Settlement is not always the right tool	11
The regulator should be a party to settlements and able to enforce them, along with the Rulings Panel	12
The Rulings Panel should be independent from the Authority	12
History of the arrangement	13
The Rulings Panel compared with similar tribunals	13
Disputes that the Rulings Panel can resolve	14
<i>There are two lists</i>	14
<i>The two lists are a relic of history, and are inefficient</i>	15
<i>The two lists can be combined into one</i>	15
6 Improving liability arrangements	17
The scope of the review	17
Are liability limits appropriate?	17
Optimal approach to structuring liability limits	18
Should liability limits be in the Enforcement Regulations?	18
What should the liability limits be?	19
Suggested limits	20
Consider linking the penalty limit to the total liability limits	20
Appendix A Strawman for Part 1 of the Enforcement Regulations	21
Appendix B Report from TDB Advisory on liability arrangements	24
References	25
Glossary of abbreviations and terms	26

Tables

Table 1: Current compliance framework	3
Table 2: Compliance monitoring programme	4

1 Introduction

- 1.1 Since 2012, the Authority has been undertaking a comprehensive review of its compliance framework, starting from first principles.
- 1.2 As part of the compliance framework review, the Authority measured its compliance framework against international best practice, to identify areas for improvement. The analysis identified aspects of the Enforcement Regulations that, if revised, would in the Authority's view make the biggest single difference in achieving a best practice compliance framework. This in turn would help the Authority achieve its statutory objective.
- 1.3 This led the Authority to closely examine the Enforcement Regulations, including the liability arrangements for certain industry participants.
- 1.4 This paper summarises the findings of the compliance framework review and how they led to a review of the Enforcement Regulations. The paper also sets out the Authority's analysis of recommended areas for improvement in the Enforcement Regulations, including liability arrangements.

2 Why did the Authority conduct this review?

The compliance framework review

- 2.1 In 2012, the Authority decided to carry out a comprehensive review of its compliance framework, starting from first principles.
- 2.2 The rationale for this review was that the current compliance framework is not fit-for-purpose and does not provide a best practice framework.
- 2.3 The Electricity Commission carried out an 'Electricity Market Compliance Framework Review' in 2008. That review indicated participants were generally supportive of the Electricity Commission's approach to compliance. However, the 2008 review looked at only seven, largely procedural, issues under the Electricity Governance Regulations 2003. The Authority considered a comprehensive review of the compliance framework on a first principles basis was both timely and desirable.
- 2.4 Further, the Electricity Industry Act 2010 (Act) has made key changes to the Electricity Commission's compliance framework, including:
- (a) the Authority now monitors, investigates and enforces compliance with the Act. The Electricity Commission had no such role
 - (b) the Authority has enhanced information-gathering powers: failure to comply with a request for information is a breach of the Code
 - (c) the Authority is accountable as a service provider for the functions it performs as market administrator
 - (d) the maximum pecuniary penalty that the Rulings Panel may award for a Code breach has increased from \$20,000 to \$200,000.

What is the Authority's compliance framework?

- 2.5 The Authority's compliance framework is the set of regulatory arrangements under which the Authority monitors, investigates and enforces the 'rules' of the New Zealand electricity market. These rules are set out in:
- (a) the Act
 - (b) any regulations made under the Act
 - (c) the Code.
- 2.6 The Authority has adopted a light-handed, improvement-based approach to compliance. Its "compliance philosophy" is:
- ...to encourage continuous improvement by industry participants in the effective, efficient and reliable operation of the electricity industry for the long-term benefit of consumers.*
- In doing this the Authority will:*
- (a) *ensure that:*
 - (i) *resources are allocated where they are most needed*
 - (ii) *"minor" breaches are fast-tracked*
 - (iii) *more serious breaches are formally investigated*
 - (iv) *the Rulings Panel deals with the more severe/complex cases*

- (b) *seek evidence that industry participants are “learning” when things go wrong, including ensuring that mitigating actions are taken to correct the problem and avoid recurrence*
- (c) *encourage settlement agreements between parties*
- (d) *take a pragmatic approach, and*
- (e) *ensure a good compliance process is always followed.*

2.7 The table below sets out the Authority’s current compliance framework.

Table 1: Current compliance framework

Compliance function	Framework
Monitor, investigate and enforce compliance with the Code	The Act (especially subpart 4 of Part 2) The Enforcement Regulations The Authority’s compliance philosophy The Authority’s internal operating procedures and guidelines The Authority’s compliance database
Monitor, investigate and enforce compliance with the Act and regulations	The Act Criminal procedure The Authority’s compliance philosophy (in part) The Authority’s internal guidelines

The Authority’s role in compliance with the Code

2.8 The Authority monitors whether participants comply with the Code, and investigates and enforces breaches of the Code. Its obligation to do this is set out in the Enforcement Regulations, which describe:

- (a) how the Authority and the Rulings Panel should deal with complaints from industry participants about Code breaches
- (b) how the Rulings Panel should deal with some disputes and appeals under the Code
- (c) membership and operation of the Rulings Panel
- (d) the liability of various industry participants.

The Authority monitors compliance with the Code

2.9 The Authority’s three main compliance monitoring activities are:

- (a) general monitoring of compliance with obligations under the Act, the Code and regulations
- (b) targeted compliance monitoring based on a risk assessment (targeted monitoring)
- (c) monitoring compliance as a service for other Authority teams (monitoring services).

2.10 The table on the next page summarises the Authority’s compliance monitoring programme.

Table 2: Compliance monitoring programme

Compliance monitoring		
Obligation to monitor	Targeted monitoring	Monitoring services
2 hour rule / 30 minute rule offer revisions	Quality of participants register information	Quality of demand-side bidding
Quality of hedge contract information	Settlement actions	Reconciliation participant audits and distributor audits
	Low fixed charge tariff option for domestic consumers ²	
	Part 3 of the Act	
	Other monitoring activities based on risk assessment	

The Authority investigates and enforces compliance with the Code

- 2.11 Monitoring is the first part of the Authority's compliance activity. It also investigates and enforces breaches of the Code. The Authority receives a steady stream of reported breaches of the Code from industry participants. This is because the Enforcement Regulations and the Code require participants to report certain Code breaches.

The Authority's role in compliance with the Act and regulations

- 2.12 The Authority also monitors, investigates and enforces compliance with the Act and regulations. Failure to comply with the Act or regulations is an offence, which the Authority may prosecute through the courts.
- 2.13 The volume of work related to compliance with the Act is relatively modest. The Authority monitors a few key areas, including whether industry participants comply with Part 3 of the Act (separation of distribution from certain generation and retailing) and the requirement in section 9 of the Act to register as an industry participant (see Table 2). To date, the Authority has taken only one prosecution - in respect of a distributor's obligation to supply electricity consumers.³

² Refer to the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004.

³ Section 105(4)(a) of the Act.

3 How did the Authority conduct this review?

The Authority designed a best practice compliance framework

- 3.1 In early 2013, the Authority designed a best practice compliance framework, based on 10 principles. The principles derive from optimal institutional design and regulation, and from optimal compliance.
- 3.2 The 10 principles are:

Principles related to compliance policy

- (a) the approach to compliance is co-ordinated across relevant regulatory bodies
- (b) the compliance and enforcement strategy is accessible and easy to understand
- (c) interpretation of rules is well understood and communicated
- (d) compliance activities are based on a sound understanding of the markets and the incentives of participants

Principles related to compliance activity

- (e) monitoring and enforcement activity is risk-based and targeted
- (f) compliance decision-making is independent and impartial; intended to deliver consistent and predictable decisions
- (g) the enforcement response is proportionate to the impact of the breach and the type of offending
- (h) there are accessible, fair and efficient mechanisms for appeal and review of decisions

Principles related to review and future development

- (i) performance measures for compliance are outcomes-based
- (j) compliance findings inform rule development and policy/regulatory settings.

The Authority found areas for improvement in the Enforcement Regulations

- 3.3 In late 2013 the Authority analysed its current compliance framework against the best practice compliance framework to identify areas for improvement.
- 3.4 The gaps identified were:

Compliance monitoring

- (a) the Authority does not have a detailed risk assessment of each participant obligation under the Code / Act / regulations, to use in its risk-based approach to compliance monitoring

Client relationships

- (b) the Authority should run more regular compliance forums for industry participants
- (c) the Authority should visit participants or classes of participants more often, to explain/discuss compliance issues

Reporting

- (d) the Authority does not publish regular reports on compliance trends, compliance monitoring results, areas of focus

Enforcement

- (e) the Enforcement Regulations:
 - (i) contain confidentiality provisions that are too restrictive
 - (ii) require compulsory settlement when there may be nothing to settle
 - (iii) have no mechanism to enforce settlement agreements
 - (iv) do not allow the Rulings Panel to review settlement agreements
 - (v) in general, contain antiquated and inflexible processes
 - (f) the sanctions the Authority can apply are administrative (warning letters or asking participants to implement a compliance plan or improve operating procedures or training). There is a sharp step up from what the Authority can do to the sanctions the Rulings Panel and the courts may impose.
- 3.5 Since a significant subset of the identified gaps related to the Enforcement Regulations, the Authority decided to review those regulations more closely. . The Authority will send its findings to MBIE, the government agency that administers the Enforcement Regulations.

The project includes a review of liability arrangements

- 3.6 The Authority has extended the scope of the Enforcement Regulations review project to include liability limits. The Authority had intended to separately review liability limits for a subset of market operation service providers,⁴ to assess whether the liability limits were consistent with the services provided. The review was also to assess the balance of risk between service providers and industry participants.
- 3.7 However, it made sense to consider liability limits as part of the review of the Enforcement Regulations. This was because any change to the liability limits would require a change to the Enforcement Regulations.
- 3.8 The Authority also decided to extend the liability limits review to look at all liability arrangements in the Enforcement Regulations. This included not only all market operation service providers, but also ancillary service agents, asset owners, and (electricity) metering standards and metering information.
- 3.9 The Authority commissioned a report from a consulting firm, TDB Advisory Limited, (TDB Advisory) to answer the following question:
- What are the most appropriate liability arrangements for market operation service providers, ancillary service agents, asset owners, and in respect of (electricity) metering standards and metering information, to assist with achieving the Electricity Authority's statutory objective?*
- 3.10 The TDB Advisory report is in Appendix B. It is relevant to section 4 of this report.

⁴ The pricing manager, reconciliation manager, clearing manager, WITS provider, registry manager and FTR manager.

4 How to improve the Enforcement Regulations

The current design of the Enforcement Regulations results from multiple 'roll-overs'

- 4.1 The Enforcement Regulations derive from multiple compliance regimes under previous electricity industry arrangements, dating back some 20 years.
- 4.2 The starting point was the New Zealand Electricity Market (NZEM) and the Metering and Reconciliation Information Agreement (MARIA). The compliance regimes for these were appropriate for electricity industry self-governance, based on multilateral contracts between market participants.
- 4.3 In the early 2000s the electricity industry proposed to merge the NZEM, MARIA and the Multilateral Agreement on Common Quality Standards (MACQS). The result was the Electricity Governance Establishment Committee (EGEC) draft rulebook.
- 4.4 This process included merging the draft MACQS compliance regime with the NZEM and MARIA compliance regimes.
- 4.5 The Electricity Governance Regulations 2003 and the Electricity Governance Rules 2003 used the EGEC rulebook as their basis. The only changes made were to reflect the move from electricity industry self-governance to having a government agency as regulator. The explanatory note to the Electricity Governance Regulations said:
- The Electricity Governance Rules made by the Minister of Energy are based largely on a rulebook written by the electricity industry, as part of a proposed move to self-governance. The version of the rulebook dated 11 April 2003 was voted on at a referendum of participants on 16 May 2003, but the vote on the rulebook (and self-governance) failed. These regulations are also based on that rulebook.*
- 4.6 When the Act came into force on 1 November 2010, the Enforcement Regulations replaced Parts 4 to 8 of the Electricity Governance Regulations.
- 4.7 Again, there was a roll-over of the existing provisions. The explanatory note to the Enforcement Regulations states the Enforcement Regulations:
- ... differ from the [Electricity Governance Regulations] in substance only so far as is necessary to reflect the changes made by the Electricity Industry Act 2010.*
- 4.8 Multilateral contracts no longer form the basis of the New Zealand electricity market. The Act, the regulations and the Code now create the regulatory framework. In a regulatory framework, the regulator should have appropriate mechanisms available to deal with non-compliance.

What the reviews found

Review of the compliance arrangements in the Enforcement Regulations

- 4.9 The Authority's review of the Enforcement Regulations found that:
- (a) there should be less prescription in the compliance processes in Part 1 of the Enforcement Regulations
 - (b) there should be greater transparency of compliance-related activities and decisions. All information used in compliance processes should be made available unless there is good reason to withhold it
 - (c) under the settlement regime:

- (i) investigators should not have to always try to settle alleged breaches of the Code
- (ii) the Authority should be a party to any settlement agreements and be able to enforce them
- (iii) the Rulings Panel should be able to hear complaints about non-compliance with settlement agreements
- (d) the Rulings Panel should not be accountable to the Authority
- (e) Part 3 of the Enforcement Regulations (disputes and appeals) is unnecessary.

Review of the liability arrangements in the Enforcement Regulations

4.10 The review of the liability arrangements found that:

- (a) a limit should be placed on the liability of the WITS provider for breaches of the Code where none currently exists
- (b) annual liability limits should be put in place for metering standards and metering information
- (c) the liability limit for the system operator should be materially increased
- (d) the liability limit for ancillary service agents should be a percentage of revenue and not an absolute limit
- (e) the liability limit for frequency keeping should be a little lower than for other ancillary services
- (f) the Authority should make only relatively modest amendments to the liability limits of the other industry participants referred to in the review.

5 Improving compliance arrangements

The compliance process is too prescriptive

- 5.1 The Authority would like to see Part 1 of the Enforcement Regulations amended so that the compliance processes are less prescriptive.
- 5.2 The Authority's compliance framework applies to the interaction of firms. Its purpose is not to protect the interests of individuals (as under the Human Rights Act 1993). In compliance frameworks that apply to the interaction of firms, the governing legislation will generally set out rules and the consequences for breaching the rules. The governing legislation will not usually detail the processes by which the regulator must enforce the rules. Nor will it usually set out all the remedies available to the regulator. Generally, legislation gives the regulator discretion to decide the best response.
- 5.3 If a compliance agency considers there has been a breach of the legislation it administers, it will assess the seriousness of the breach, the extent of the harm, and the public interest in how it deals with the breach. One option is to prosecute. However, the regulator is more likely to use one of a range of tools, not set out in the governing legislation. For example, the agency may issue a warning, or require the party in breach to correct its behaviour, or both. Where legislation does not specify any enforcement tools, the courts have supported the use of this kind of discretion.⁵
- 5.4 The government publication *Achieving Compliance – A Guide for Compliance Agencies in New Zealand* supports the idea that compliance agencies should adopt flexible approaches, using a range of enforcement tools not all necessarily specified in legislation.⁶ *Achieving Compliance* was the result of collaboration among compliance practitioners across New Zealand's public sector. It outlines the core components of best-practice compliance management in New Zealand. It recommends that compliance agencies adopt a graduated range of compliance responses. The range includes encouraging voluntary compliance, bringing non-compliant persons into compliance, and punishing those who breach rules in a serious and/or repeated way.
- 5.5 A compliance agency needs to have discretion in deciding whether, and when, to take action. It needs to be able to take different approaches to compliance from time to time, based on the agency's assessment of trends and risks in compliance behaviour. It may shift its compliance focus to different provisions, or to different segments of the regulated industry.
- 5.6 Part 1 of the Enforcement Regulations does not allow for this. Instead it provides a prescriptive process characterised by:
- (a) a lengthy process prior to the appointment of investigators (regulations 12-15)
 - (b) detailed instructions for tasks that must be completed before an investigation can start (regulations 16-17)
 - (c) prescriptive requirements for the content of an investigator's report (regulation 19)
 - (d) prescriptive and mandatory investigation and settlement processes (regulations 20-29).

⁵ Refer for instance to *Hallett v Attorney General* [1989] 2 NZLR 87.

⁶ Available at: [http://www.dia.govt.nz/diawebsite.nsf/Files/Achieving%20Compliance%20-%20A%20Guide%20for%20Compliance%20Agencies%20in%20New%20Zealand/\\$file/AchievingComplianceGuide_17July2011.pdf](http://www.dia.govt.nz/diawebsite.nsf/Files/Achieving%20Compliance%20-%20A%20Guide%20for%20Compliance%20Agencies%20in%20New%20Zealand/$file/AchievingComplianceGuide_17July2011.pdf)

- 5.7 Much of this detail should be set out in compliance procedures that the Authority publishes,⁷ rather than in regulation. This would be consistent with best practice in similar compliance frameworks.
- 5.8 Removing some of the prescription from the Enforcement Regulations would also reduce the need to change them in future. Prescriptive provisions tend to have more cross-references to the Code. Removing those provisions and the cross-references in them, removes the requirement to update the Enforcement Regulations if the Code changes.
- 5.9 Appendix A contains a 'strawman' Part 1 of the Enforcement Regulations based on the proposed approach set out above. The strawman illustrates the Authority's suggested changes to the Enforcement Regulations to reduce the level of prescription in the compliance processes.

Confidential information should be the exception rather than the rule

- 5.10 The Authority would like to see the Enforcement Regulations amended so that all information used in compliance processes is available unless there is a good reason to withhold it.
- 5.11 Currently, the Authority must keep confidential *all* information provided or disclosed to it under Part 1 of the Enforcement Regulations. The only exception is if disclosure is required to enable the Authority to carry out its obligations and duties under the Enforcement Regulations or the Code, or the law requires it.
- 5.12 Similarly, investigators must keep *all* information provided or disclosed to them confidential, and must ensure that all persons appointed under regulation 14 of the Enforcement Regulations keep confidential all information provided or disclosed to them, unless they are required to disclose:
- (a) to enable the Authority or an investigator or other person to carry out their obligations and duties under the Code or the Enforcement Regulations, or
 - (b) because the law requires it.
- 5.13 Compliance activities in best practice compliance frameworks are as transparent as possible. The requirement to keep information confidential should apply only to information that has '*the necessary quality of confidence about it*'.⁸
- 5.14 All information used in a compliance process should be available unless there is a good reason to withhold it (for example to protect privacy or to avoid prejudice to commercial position). This principle is important to promote decision-making that is:
- (a) impartial and seen to be impartial
 - (b) independent, consistent and predictable.
- 5.15 The confidentiality requirements in the Enforcement Regulations are unnecessarily broad. A practical example of this is that the Compliance Committee may not publish minutes of its meetings. Publishing the minutes would provide greater transparency around how the Committee reaches decisions. This would help industry participants better understand the compliance process and how the Authority interprets the Code. This in turn provides them with information to modify their behaviour to better comply with the Code.

⁷ For example, refer to the Authority's various compliance guidelines and operating procedures, available at <http://www.ea.govt.nz/act-code-regs/compliance/>.

⁸ Office of the Ombudsman Practice Guidelines – Part 2C: Other reasons for refusing official information - Confidentiality.

The existing settlement process

- 5.16 Under the current compliance framework, a person investigating an alleged breach must try to effect a settlement between the parties in breach. The process for dealing with complaints about breaches of the Code is as follows:
- (a) the Authority receives reports of breaches of the Code
 - (b) the Authority decides whether to investigate and, if so, appoints an investigator
 - (c) the investigator:
 - (i) notifies the relevant parties and publicises the matter
 - (ii) *must* attempt to reach a settlement of *every* matter under investigation by agreement between the parties to the investigation
 - (d) if settlement is reached, it is submitted to the Authority, which must either accept or reject it
 - (e) if settlement is not reached, or if the Authority rejects the settlement, the Authority may lay a formal complaint with the Rulings Panel
 - (f) if the Authority decides not to lay a formal complaint, a participant that was a party to the investigation and has suffered loss may independently lay a formal complaint with the Rulings Panel.

Settlements should not be compulsory

- 5.17 Settlements are a useful enforcement tool, because they are faster and cheaper than judicial enforcement.
- 5.18 The Enforcement Regulations assume that the most appropriate way to resolve a breach of the Code is by settlement between the parties, as would be the case in a contractual arrangement.
- 5.19 Settlements may be a useful tool but there are two problems with how they operate under the Enforcement Regulations:
- (a) industry participants resist the inclusion of privity clauses in settlements which would give the Authority, as a third party to the settlement, the right to enforce the settlement terms
 - (b) the Rulings Panel cannot hear complaints about compliance with settlements.

Settlement is not always the right tool

- 5.20 The process requires the investigator to attempt a settlement between the parties in every case. However, the parties may have no interest in a settlement.
- 5.21 Not all breaches of the Code require, or are capable of, settlement. It can be more efficient to refer a breach straight to the Rulings Panel. This will be the case if it is not possible to identify all the parties to the breach, or to ascertain the impact of the breach on all of them.
- 5.22 If there is a clear breach of the Code and the parties agree, there is nothing to settle. The only live issue is the appropriate sanction, if any, for the party in breach.
- 5.23 The Authority can lay a formal complaint to the Rulings Panel only if the parties do not reach a settlement, or if the Authority rejects a settlement. This further illustrates the unwieldy nature of the process. There is no 'fast-track' process to refer a formal complaint to the Rulings Panel where the only issue is whether the Rulings Panel should make a remedial order (for example imposing a penalty) against the party in breach.

- 5.24 Under a best practice compliance framework, settlements should not be compulsory. Instead, they should be just one of a range of options available to deal with non-compliance.

The regulator should be a party to settlements and able to enforce them, along with the Rulings Panel

- 5.25 Under a best practice compliance framework, settlements would be between the compliance agency and the party in breach, rather than being between the party in breach and other affected parties. This is more suitable for a government-regulated electricity industry structure (the current model) rather than a model based on multilateral contracts. It would mean that the Authority would be able to enforce the terms of settlement agreements.
- 5.26 Under a best practice compliance framework, the Rulings Panel would have the jurisdiction to determine issues regarding compliance with settlement agreements.
- 5.27 The Authority would prefer to see the Enforcement Regulations amended so that:
- (a) it is not compulsory for an investigator to attempt to effect a settlement
 - (b) the Authority could be a party to a settlement agreement
 - (c) the Rulings Panel could hear complaints about compliance with settlement agreements.

The Rulings Panel should be independent from the Authority

- 5.28 The Authority believes that the Rulings Panel should be independent from the Authority. The Authority would like to see a change to the Enforcement Regulations as to who administers the Rulings Panel and who the Rulings Panel is accountable to.
- 5.29 Currently the Authority administers and funds the Rulings Panel. The Rulings Panel is also accountable to the Authority through a variety of means, including:
- (a) the chairpersons of the Authority and the Rulings Panel must agree on:
 - (i) a budget for the coming year to cover expenses anticipated by the Rulings Panel⁹
 - (ii) any performance objectives for the next 12 months¹⁰
 - (b) the Rulings Panel must provide written monthly reports to the Authority on actual versus budgeted costs¹¹
 - (c) the Rulings Panel must notify the Authority of anticipated expenditure in excess of budget and apply for a variation to the agreed budget¹²
 - (d) the Rulings Panel must report quarterly to the Authority on matters including decisions made, current workload and information about breaches¹³
 - (e) the Rulings Panel must report annually to the Authority on matters including performance against budget, decisions made, and performance against agreed performance objectives.¹⁴

⁹ Regulation 113(1).

¹⁰ Regulation 113(1).

¹¹ Regulation 113(2).

¹² Regulation 113(3).

¹³ Regulation 114.

¹⁴ Regulation 115.

History of the arrangement

- 5.30 The requirement to agree performance objectives is a legacy from the attempt, in 2003, to establish an electricity industry governance structure based on a single multilateral contract.
- 5.31 In December 2000 the Government Policy Statement on Electricity (GPS) required the industry to establish a single governance arrangement. It also required the industry to create a Board to govern the new arrangement. The Board was to have ultimate responsibility for enforcing the rules. The Rulings Panel was to be accountable to the Board.
- 5.32 Under the new rules the Board could appoint and remove the members of the Rulings Panel. The chairpersons of the Board and of the Rulings Panel were to agree on the Rulings Panel's budget and performance objectives for the next 12 months. The Rulings Panel was then to provide the Board with reports on:
- (a) actual costs incurred compared with budgeted costs
 - (b) Rulings Panel's decisions, workload, non-compliance with certain parts of the rules, and any other concerns
 - (c) the Rulings Panel's budgetary performance, decisions, performance against agreed performance objectives, and any rule changes required.
- 5.33 These requirements continued unchanged into the 2003 Electricity Governance Regulations.
- 5.34 The review of the Enforcement Regulations has considered the appropriateness of these requirements, particularly when the Authority may be a party to proceedings before the Rulings Panel.

The Rulings Panel compared with similar tribunals

- 5.35 The review of the Enforcement Regulations looked at how other New Zealand tribunals operate and compared them to the Rulings Panel. The review considered:
- (a) the New Zealand Law Commission's review of New Zealand's tribunal arrangements¹⁵
 - (b) a surveyed 10 tribunals in New Zealand that share the following three key features of the Rulings Panel:
 - (i) hears complaints about breaches of the law
 - (ii) resolves disputes between people
 - (iii) hears administrative appeals (appeals of decisions made under legislation)¹⁶
 - (c) the Legislation Advisory Committee Guidelines on Process and Content of Legislation.
- 5.36 The Law Commission's paper states that if a department that appears as a party before a tribunal also administers the tribunal, the tribunal may appear to be less than independent.¹⁷ The same reasoning would apply to a Crown entity like the Authority.

¹⁵ New Zealand Law Commission, *Tribunals in New Zealand* (NZLC IP 6, Wellington 2008).

¹⁶ Advertising Standards Complaint Board, Benefit Review Committees, Broadcasting Standards Committee, Copyright Tribunal, Customs Appeal Authority, Employment Relations Authority, Human Rights Review Tribunal, Motor Vehicle Disputes Tribunal, New Zealand Market Disciplinary Tribunal, Social Security Appeal Authority.

¹⁷ New Zealand Law Commission, 2008, *Tribunals in New Zealand*, (NZLC IP 6, Wellington 2008), p. 85.

- 5.37 The Legislation Advisory Committee Guidelines recommend that, if a department may be required to appear as a party before a tribunal, the same department should not (where practicable) provide administrative services to the tribunal.¹⁸
- 5.38 In addition, where a tribunal reviews decisions made by a government agency, the Law Commission's view is that the agency should not administer the tribunal.¹⁹ This is the situation for the Rulings Panel and the Authority (see section 49 of the Act, where the Rulings Panel can review the Authority's decision to suspend trading by a generator or retailer under the Code).
- 5.39 The Law Commission considers there is significant duplication of effort across the various government agencies administering tribunals.²⁰
- ‘Current administrative arrangements for tribunals can best be described as ad hoc and variable, with each different administering agency taking its own approach on the nature and level of support provided. Each determines and develops its own staffing ratios, training arrangements, case management systems and IT systems. There is currently an absence of central support or guidance on the administration of tribunals. The result is a high level of variation in practice. We do not consider that the limited resources that are currently available to tribunals are utilised as efficiently as they could be.’
- 5.40 The Tribunals Unit of the Ministry of Justice provides administrative and registry support services to approximately 30 tribunals. Consistent with the Law Commission's view, the Authority considers it may be more appropriate for the Rulings Panel to be administered by, and accountable to, the Ministry of Justice. Another government agency that may be appropriate for these roles is MBIE, given its policy oversight role in the electricity sector. However, administering and managing tribunals is not a core function of MBIE.
- 5.41 If the Ministry of Justice were responsible for agreeing the Rulings Panel's expenditure, then to ensure the correct incentives were in place, the Authority considers the Ministry of Justice should also be responsible for funding the Rulings Panel. However, this would require an amendment to the Act (section 26).

Disputes that the Rulings Panel can resolve

There are two lists

- 5.42 Under the Act, the Rulings Panel may resolve disputes of a kind identified in regulations or in the Code.²¹ The Enforcement Regulations identify two kinds of disputes that the Rulings Panel can resolve:
- (a) a dispute in relation to the submission of information provided for the purposes of reconciliation under Part 15 of the Code
 - (b) a dispute that relates to a contract for the procurement of ancillary services.
- 5.43 In contrast, under the Code, the Rulings Panel may resolve a much larger number of disputes, including:
- (a) distributed generation dispute resolution – clause 6.8 of the Code

¹⁸ Legislation Advisory Committee, 2012, Legislation Advisory Committee Guidelines on Process and Content of Legislation, p.164.

¹⁹ New Zealand Law Commission, 2008, Tribunals in New Zealand, (NZLC IP 6, Wellington 2008), p. 85.

²⁰ Ibid, p136.

²¹ Section 112.

- (b) disputes regarding system operator determinations – clause 8.62 of the Code
- (c) metering dispute resolution – clause 10.50 of the Code
- (d) default transmission agreement dispute resolution – clauses 12.45-12.47 of the Code
- (e) use of system agreement dispute resolution – clause 12.A3 of the Code
- (f) prudential requirement dispute resolution – clause 14.29 of the Code
- (g) invoice dispute resolution – clause 14.64 of the Code
- (h) reconciliation (volume) information dispute resolution – clause 15.29.

The two lists are a relic of history, and are inefficient

- 5.44 The only reason there are two kinds of disputes specifically identified in the Enforcement Regulations is because the Enforcement Regulations are the result of multiple roll-overs, as discussed earlier. There is no need for the Enforcement Regulations to identify which categories of disputes the Rulings Panel can hear, as the Act (section 112) provides for the Code to specify the categories.
- 5.45 Best practice would be not to have various kinds of disputes identified both in the Enforcement Regulations and in the Code. This is likely to lead to doubling up of processes, and risks inconsistencies in approach. The dispute resolution processes in clause 15.29 of the Code and in the Enforcement Regulations are already different. For example:
- (a) clause 15.29 allows a party to start a volume information dispute, and refer the dispute to the Rulings Panel if it cannot be resolved within 15 business days. In contrast, regulation 80(1) says that a reconciliation information dispute may be referred to the Rulings Panel only if both parties to the dispute agree
 - (b) clause 15.29(4) allows the Authority to direct that the dispute will not proceed further. The Enforcement Regulations do not give the Authority such a power
 - (c) the Enforcement Regulations give the Rulings Panel the discretion whether to determine a reconciliation dispute. It has no similar discretion under the Code
 - (d) clause 15.29 of the Code specifies timeframes for raising disputes, whereas the Enforcement Regulations do not
 - (e) clause 15.29 of the Code includes detailed requirements as to what participants, the reconciliation manager and the clearing manager must do if the outcome of a dispute is that information must be corrected (including, for example, the re-issuing of seasonal adjustment shapes and conducting wash ups). The Enforcement Regulations say only that the Rulings Panel may make any order in respect of a dispute that it considers is just and reasonable in the circumstances.
- 5.46 If there are inconsistencies between the Enforcement Regulations and the Code, the Enforcement Regulations take precedence. However, in the example above, the more recently-developed Code provisions are better than those in the (older) Enforcement Regulations.

The two lists can be combined into one

- 5.47 The legislative framework would be simpler if the Code listed all disputes that the Rulings Panel could determine. If the Government revoked regulation 78(a), the Authority could add one further category to the list of disputes the Rulings Panel can determine under the Code – disputes about contracts for procuring ancillary services.

- 5.48 The Code could incorporate the procedures in Part 3 of the Enforcement Regulations unchanged, so long as they were best practice. Alternatively, the Rulings Panel could decide the procedures for determining such a dispute (in accordance with section 53(2) of the Act).
- 5.49 The Authority would like to see the Code amended so that the Rulings Panel resolves disputes about procurement contracts for ancillary services.
- 5.50 Part 3 of the Enforcement Regulations would then be unnecessary.

6 Improving liability arrangements

- 6.1 The Authority engaged TDB Advisory to review liability limits under the Enforcement Regulations, and recommend a best approach to structuring liability limits, and where to locate them.

The scope of the review

- 6.2 The Enforcement Regulations limit the amount of liability of market operation service providers (except the WITS provider), ancillary service agents, asset owners, and industry participants in respect of (electricity) metering standards and metering information.

- 6.3 As with other provisions in the Enforcement Regulations, the liability limits are the result of multiple roll-overs. Some of the liability limits date back to 1994.

- 6.4 The Authority engaged TDB Advisory to prepare a report that answered the following question:

What are the most appropriate liability arrangements for market operation service providers, ancillary service agents, asset owners, and in respect of (electricity) metering standards and metering information, to assist with achieving the Electricity Authority's statutory objective?

- 6.5 The Authority asked TDB Advisory to carry out its review starting from first principles. The scope of the review was as follows:

- (a) with reference to the economics of liability, whether having liability limits in place for market operation service providers, ancillary service agents, asset owners, and in respect of (electricity) metering standards and metering information, is consistent with the Authority's statutory objective
- (b) if having liability limits in place in regard to the above are consistent with the Authority's statutory objective, then:
 - (i) the optimal approach to structuring the liability limits (for example a per event liability cap; an annual liability cap; a combination of a per event liability cap and an annual liability cap; an absolute dollar value liability cap; an absolute dollar value liability cap indexed to inflation; a liability cap that is a percentage of the annual service provider fees; a combination of an absolute dollar value liability cap and a percentage of annual service provider fees)
 - (ii) whether the liability limits should be set out in the Enforcement Regulations, the Code or the market operation service provider agreements with the Authority
 - (iii) an appropriate level of liability for each relevant party.

- 6.6 Outside the scope of the review was whether the liability arrangements in the Enforcement Regulations should be expanded (other than in regard to the WITS provider) to include other services provided by industry participants.²²

Are liability limits appropriate?

- 6.7 The review of the liability arrangements concluded there are net benefits from having limits on the liabilities various participants in the New Zealand electricity industry face in relation to breaches of the Code. Limiting liability increases competitiveness in the electricity market by reducing barriers to entry, while still providing a good balance between the incentive for providers of

²² The term 'service' also includes asset owners supporting the system operator's common quality and security objectives.

services to secure electricity supply and the freedom to take on risks that promote the long term efficiency of the industry.

Optimal approach to structuring liability limits

- 6.8 The review of the liability arrangements concluded these liability limits should continue to be structured using a combination of per event and annual caps. Per-event caps provide certainty and consistent incentives for the parties subject to the liability limits, and give a clear indication to other parties of the extent of the compensation they may be able to receive if harmed. The annual cap provides a clear and quantifiable risk over a common timeframe for which parties can seek insurance.
- 6.9 For the market administrator, asset owners and in respect to metering standards and metering information, linking liability limits to revenue received for the service does not make sense. Absolute liability limits are appropriate for these parties. For the market operation service providers other than the market administrator, the limits should be absolute dollar liability limits. For ancillary service agents, liability limits linked to revenue are preferred to absolute limits. This is because collectively ancillary service agents provide a range of different ancillary services and are of different sizes. Hence, an absolute liability limit will not provide as consistent an incentive as will a limit based on a percentage of revenue.
- 6.10 Lastly, there should be a review of liability limits every three to five years, to allow for changes in market conditions.

Should liability limits be in the Enforcement Regulations?

- 6.11 Currently, section 112(1)(i) of the Act provides that liability limits for Code breaches may be placed in regulations.²³ The Authority considers that keeping the liability limits in the Enforcement Regulations is the most appropriate balance between certainty, flexibility and cost-effectiveness.
- 6.12 The alternatives are to place the liability limits either in the Act or in the Code. Liability limits should not be in a service provider agreement (for example between the Authority and market operation service providers, or between the system operator and ancillary service agents) because those agreements concern only the parties to them. Limits on liability in service provider agreements cannot limit the service provider's liability for a breach of the Code.
- 6.13 Placing the limits in the Act instead of the Enforcement Regulations would impose material transaction costs if a change to one or more of the limits was made, or if a new limit was to be put in place (for example for a new service provision role).
- 6.14 If liability limits were in the Code as opposed to the Enforcement Regulations there would be more flexibility to set and amend the limits. However, the Code is more easily amended than the Enforcement Regulations and industry participants might consider that this increased uncertainty. This approach would also appear to require an amendment to the Act.
- 6.15 As noted above, the Act provides that regulations may be made that limit liability. This suggests that, in providing the Authority with a general power to amend the Code, Parliament did not intend for the Authority to amend the Code to include liability limits, because it had delegated that power to the Governor-General.

²³ Section 112(1)(i) states that the Governor-General may make regulations "restricting or limiting the amount of liability of, or the amount of any penalty that may be imposed upon, an industry participant or class of industry participant".

- 6.16 If the Authority amended the Code to include liability limits, the Regulations Review Committee may criticise the Authority, on the basis that the regulation-making power in section 112(1)(i) of the Act creates an expectation that such liability limits be set by regulation.²⁴
- 6.17 Given that the review of liability arrangements concludes that amendments to liability limits should occur every three to five years, retaining the liability limits in the Enforcement Regulations provides the most appropriate balance between certainty, flexibility and cost-effectiveness.

What should the liability limits be?

- 6.18 The liability arrangements review adopted a methodology for estimating proposed liability limits which may be summarised as follows:
- (a) assess value-at-risk
 - (b) assess liability cap-to-revenue ratio
 - (c) derive indicative annual liability limits
 - (d) assess per event to annual cap ratio
 - (e) derive indicative per event liability limits
 - (f) compare with current liability arrangements
 - (g) assess service-specific to arrive at proposed liability limits.
- 6.19 First, the review assessed each service qualitatively, and at a high level. This produced an estimated value at risk for each service. To help assess risk, the review asked two high-level questions:
- (a) how often would a provider materially adversely affect industry participants?
 - (b) what is the likely per-event impact for each participant (worst case scenario)?
- 6.20 The review then used current annual revenue generated by each service to derive indicative annual liability cap ranges for each provider by imposing liability cap-to-revenue ratios that increase as the value at risk increases.
- 6.21 The link between revenue and liability limits is important. The greater the value at risk, all else being equal, the greater the proportion of a service provider's contracted revenue that should be at risk if a material error occurs. Similarly, for a low risk, low impact service a lower liability limit-to-revenue ratio is appropriate.
- 6.22 The review then derived indicative per-event liability limit ranges from the indicative annual liability caps and the expected frequency of harm. Different relationships between per event and annual liability limits are appropriate for providers that can materially adversely affect other industry participants at different frequencies.
- 6.23 The review applied the methodology consistently across market operation service providers, ancillary service agents, asset owners, and in respect of (electricity) metering standards and metering information. To test the appropriateness of the conclusions, and arrive at a liability limit range for each service, the analysis then considered the indicative liability limit ranges in the context of:

²⁴ Standing Order 315(2)(c) states that the Regulations Review Committee may draw the House's special attention to a regulation if it appears to make some "unusual or unexplained use of the power conferred by the statute under which it is made". As section 33 of the Act provides that the Code is a disallowable instrument, the Code comes within the Committee's powers under the Standing Order.

- (a) the current and historical liability arrangements, and
- (b) service-specific factors.

Suggested limits

6.24 The review concluded that consideration be given to adopting the following liability limits for market operation service providers, ancillary service agents, asset owners, and for industry participants in respect of (electricity) metering standards and metering information:

- (a) for the system operator, limits in the range of \$2 million to \$5 million per event and \$10 million to \$20 million per annum
- (b) for the WITS provider, liability limits be included in the Enforcement Regulations in the range of \$700,000 to \$1 million per event and \$1.4 million to \$2 million per annum
- (c) for the pricing manager, limits in the range of \$250,000 to \$400,000 per event and \$500,000 to \$750,000 per annum
- (d) for the reconciliation manager, limits in the range of \$500,000 to \$800,000 per event and \$1 million to \$1.6 million per annum
- (e) for the clearing manager, limits in the range of \$1.5 million to \$2 million per event and \$3 million to \$4 million per annum
- (f) for the FTR manager, limits in the range of \$250,000 to \$350,000 per event and \$1.3 million to \$1.7 million per annum
- (g) for the registry manager, limits in the range of \$50,000 to \$100,000 per event and \$230,000 to \$450,000 per annum
- (h) for the market administrator, limits in the range of \$100,000 to \$230,000 per event and \$230,000 to \$450,000 per annum
- (i) in respect to metering standards, limits in the range of \$130,000 to \$200,000 per event and \$1 million to \$1.5 million per annum
- (j) for asset owners, limits in the range of \$1.5 million to \$2 million per event and \$3 million to \$4 million per annum
- (k) for frequency keeping, limits in the range of 50% to 75% of annual revenue per event and 100% to 150% of annual revenue per annum, with the absolute dollar limits removed
- (l) for all other ancillary services, limits in the range of 75% to 100% of annual revenue per event and 150% to 200% of annual revenue per annum, with the absolute dollar limits removed.

Consider linking the penalty limit to the total liability limits

6.25 The review concluded by recommending that consideration be given to linking the penalty limit to the total liability limits for each service, or removing the penalty limit entirely and allowing the Rulings Panel to use its discretion on a case-by-case basis.

Appendix A Strawman for Part 1 of the Enforcement Regulations

- A.1 This section is a strawman for revising Part 1 of the Enforcement Regulations. The purpose of the strawman is to help MBIE assess the Authority's suggested changes to reduce the level of prescription in the compliance processes. The strawman is an illustration only, and not an attempt to draft a revised set of Enforcement Regulations.
- A.2 This strawman incorporates the Authority's preference to see the Enforcement Regulations amended so that investigators are not required to attempt to effect a settlement when investigating an alleged breach of the Code.

Part 1 Complaints about breaches of Code

Overview of process under this Part

Overview

- (1) The Authority may receive reports of a Code breach because an industry participant is required to report them, or because any person voluntarily reports a breach.
- (2) If the Authority decides to pursue a reported breach, it may appoint an investigator.
- (3) The Authority may lay a formal complaint with the Rulings Panel.
- (4) If the Authority decides not to lay a formal complaint, an industry participant that was a party to the alleged breach and that has suffered loss because of it may independently lay a formal complaint with the Rulings Panel.
- (5) This regulation is by way of explanation only. If any other provision of the Act or these regulations conflicts with it, the other provision prevails.

Complaints to industry participants

Complaints to industry participants

Any person may complain, in writing, to an industry participant about any business activity of the industry participant that the person believes might constitute a breach of the Code.

Industry participants to investigate complaints

- (1) If someone makes a complaint to an industry participant, under regulation [x] the participant must investigate the complaint promptly, thoroughly, and fairly, and take appropriate action.
- (2) The industry participant must promptly give written notice of the result of the investigation and the action (if any) taken by the industry participant to both—
 - (a) the person who made the complaint; and
 - (b) the Authority.

Mandatory reporting by industry participants

Mandatory reporting of common quality or security breaches

- (1) If an industry participant believes on reasonable grounds that it or another industry participant has breached a provision of the Code that is about common quality or security, the industry participant must report the alleged breach to the Authority as soon as practicable after it becomes aware of the alleged breach.
- (2) The report must be in writing and must specify—
 - (a) the industry participant that is alleged to have breached the Code; and
 - (b) the provision of the Code allegedly breached; and

- (c) the circumstances relating to the alleged breach; and
 - (d) the date and time the alleged breach occurred.
- (3) This regulation does not limit any other obligation to report a breach that the regulations or the Code impose.
- (4) An industry participant that fails to comply with subclause (1) commits an offence and is liable on summary conviction to a fine not exceeding \$20,000.

Mandatory reporting of other breaches

- (1) An industry participant that believes, on reasonable grounds, that another industry participant has breached the Code must report the breach or possible breach to the Authority as soon as possible.
- (2) The report must be in writing and must specify—
- (a) the industry participant that is alleged to have breached the Code; and
 - (b) the provision of the Code allegedly breached; and
 - (c) the circumstances relating to the alleged breach; and
 - (d) the date and time the alleged breach occurred.
- (3) This regulation does not limit any specific obligation to report a breach that regulations or the Code impose on an industry participant.

Voluntary reporting of breaches

Voluntary reporting of breaches

Any person other than an industry participant who believes on reasonable grounds that an industry participant has breached the Code may report the alleged breach to the Authority.

Authority response to reported breaches

Authority may decline to act on reported breach or notify the Rulings Panel

- (1) The Authority may decline to take action on any report of an alleged breach of the Code or notify the Rulings Panel of an alleged breach of the Code.

Publication of decisions

- (1) If the Authority decides not to take further action under regulation [x], it must inform the industry participant or other person that reported the breach and publicise its decision, together with the reasons for the decision.
- (2) However, the Authority may decide not to publicise any part, or all, of a particular decision if the Authority considers that there are special circumstances that justify the non-publication.

Authority may refer alleged breach to Rulings Panel

- (1) The Authority may notify the Rulings Panel of an alleged breach of the Code.

Industry participant independently referring alleged breach of the Code to the Rulings Panel

- (1) An industry participant that believes that another industry participant is in breach of the Code may notify the Rulings Panel of the alleged breach if—
- (a) the industry participant notified the Authority of the alleged breach; and
 - (b) the industry participant has suffered loss as a result of the alleged breach; and
 - (c) the Authority has informed the industry participant that it does not propose to refer the alleged breach to the Rulings Panel.

Information to be included in notices

- (1) A notice of alleged breach referred to the Rulings Panel under regulation [x] or [x] must include the following information:

- (a) the name of the industry participant that reported the breach or, if the alleged breach is one of which the Authority became aware by any other means, that fact; and
 - (b) the provision of the Code allegedly breached; and
 - (c) the circumstances relating to the alleged breach; and
 - (d) the date and time the alleged breach occurred.
- (2) The notice may contain any additional evidence or material that the party giving the notice thinks fit.

Appendix B Report from TDB Advisory on liability arrangements

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Glossary of abbreviations and terms

Act	Electricity Industry Act 2010
Authority	Electricity Authority
Code	Electricity Industry Participation Code 2010
EGEC	Electricity Governance Establishment Committee
Enforcement Regulations	Electricity Industry (Enforcement) Regulations 2010
FTR	Financial Transmission Right
GPS	Government Policy Statement on Electricity, December 2000
MACQS	Multilateral Agreement on Common Quality Standards
MARIA	Metering and Reconciliation Information Agreement
MBIE	Ministry of Business, Innovation, and Employment
NZEM	New Zealand Electricity Market
WITS	Wholesale Information and Trading System