

9TH ANNUAL POWER NEW ZEALAND 2007
MICHAEL CLARK
DIRECTOR, NETWORKS - COMMERCE COMMISSION
26 FEBRUARY 2007

1. Good afternoon and thank you for the opportunity to provide a brief update on the Commerce Commission's work across the energy sector.
2. I will first talk about some of the key competition and regulation activity that has occurred over the past twelve months.
3. I will then focus on some of the issues and consequential work looking forward.

KEY COMPETITION ACTIVITY

Retail Investigation

4. The Commerce Act is one of the key pieces of legislation enforced by the Commission. Part II of the Act prohibits understandings that substantially lessen competition; price fixing; and taking advantage of market power to deter entry into a market.
5. At present the Commission is investigating whether there have been breaches of Part II of the Commerce Act with respect to particular activities conducted in New Zealand's wholesale and / or retail electricity markets.
6. This investigation has been as a result of numerous complaints from residential and business customers to the Commission about not just prices but also other behaviour in the marketplace.
7. The data being analysed is extensive and will be used to determine whether or not breaches of Part II exist.
8. The Commission is seeking to complete this investigation in as timely manner as possible but will continue to do so in a thorough and considered manner.
9. Further information on the status of the investigation will be provided by the Commission as the investigation progresses.

Joint Marketing of Gas

10. The Commission, in June 2006, revoked an authorisation it had given to the Pohokura joint venture partners to jointly market gas from the Pohokura field.
11. For those not familiar with the case, in 2003 the Commission concluded that if the parties in the joint venture (Shell, Todd and OMV) marketed and sold the gas in the field jointly, the gas production market would be less competitive than it would be if each had sold their equity share of the gas separately. However, the Commission on application authorised joint marketing because it was persuaded by the parties that joint marketing was necessary to achieve early production from the field.
12. Subsequently things turned out somewhat differently from what had been anticipated. The joint venture parties who had previously been adamant that separate marketing was extremely difficult and would cause delays in field development of perhaps seven years, discovered that it was easier to separately market. They then proceeded to sell separately rights to perhaps half the reserves of the field without it causing any obvious delay in field development.
13. In other words the predominant benefit claimed for joint marketing (and the one on which the Commission based its authorisation) was lost. On consideration there appeared to be a material change in circumstances.
14. As a result the Commission considered it appropriate to revoke the authorisation. Consequently any future variation from separate marketing of Pohokura gas will put the parties at risk of breaching the Commerce Act.
15. The key lesson which can be learnt from the case is that the Commission will have no compunction about revoking authorisations it issues under the Commerce Act if it is demonstrated that they were based on material changes in circumstances or false and misleading information.
16. It is also important to note that the Commission does not have a general objection to the joint development of gas fields, or the joint marketing of gas from those fields. Each case is considered on its merits.
17. The important relevant feature of Pohokura is the significance of the field (accounting for something like 39% of New Zealand's total reserves) and the significance of the joint venture parties (which between them have a substantial interest in other fields together accounting for around 77% of

total reserves). Other parties with other fields are very unlikely to raise the same competition concerns.

EIRA

18. In addition to the work under the Commerce Act the Commission also has responsibility for the Electricity Industry Reform Act (EIRA).
19. In 2001 the Act was amended to allow for lines companies to invest in unlimited new renewable generation activities, provided that such were made in accordance with corporate separation and arms-length provisions of the Act. In 2004 the Act was again amended to allow lines companies to invest in any type of electricity generation of up to 50 MW or 20% of the maximum demand on the network, whichever is the greater, provided they comply with the corporate separation and arms-length provisions.
20. In 2006 the Commission received three key applications for exemption from the provisions of the Act: Unison Networks; Eastland Networks; and Westpower. The Westpower application was similar to the Unison application's circumstances so I will deal with these together.

Unison and Westpower Exemptions Granted

21. In March 2006, The Commission granted a limited exemption to Unison in respect of certain Arms Length Rules to allow for the appointment of directors to the board of the joint venture company to construct and operate a wind farm in Northern Hawke's Bay. The exemption required the other Arms Length Rules to be observed. The exemption is also conditional on Unison not retailing the electricity to customers located on its own network, and on the generation asset not being connected to Unison's electricity lines networks.
22. Unison always clearly proposed not to retail the electricity to customers connected to its own network but rather to connect to the national grid.
23. Westpower applied for a limited exemption for a proposed 6 MW hydro generation plant in South Westland. Westpower plans to undertake this project through an 80/20 joint venture arrangement. The joint venture intends to inject the output into Westpower's electricity distribution network and to enter into a contract for differences with an electricity retailer.
24. In October 2006, The Commission granted a limited exemption to Westpower. As for the Unison exemption, the exemption required Westpower to comply with certain Arms Length Rules, and prohibited Westpower from selling electricity to any end-use customer connected to its electricity network.

I

Eastland Exemption declined

25. Eastland also applied to operate a wind farm to be constructed near Gisborne. Eastland also sought an exemption from the obligation to comply with the Arms Length Rules and from the prohibition against trading in electricity hedges. Eastland, as part of its proposal, intended to retail the electricity generated directly to customers on its own network.
26. The Commission determined that the granting of an exemption would be likely to create incentives and opportunities to inhibit competition in the electricity industry, particularly in respect of the retailing of electricity in those areas where the distribution network is operated by Eastland.
27. The Commission considered that such incentives and opportunities would include the potential for the lines business delaying or inhibiting access to its lines by its retail competitors and the lines business having information advantages regarding customers on its network, to the disadvantage of its retail competitors.

Conclusions with respect to EIRA Applications

28. While the amendments to the Act allow lines businesses to be involved in electricity supply, it does still require that those companies meet corporate separation and arms-length provisions to limit the extent to which they can favour their own activities over other electricity supply businesses.
29. In the case of Eastland, the Lines Business proposed to retail electricity generated to users connected to its own network. This had the clear potential to inhibit other electricity retailers from competing with its retail business.
30. In Unison and Westpower's cases there are no realisable incentives to inhibit retail competition as they are either selling straight into the national grid, or wholesaling to an electricity retailer.
31. Finally I note that we do have a number of current applications for exemption to the EIRA rules, most notably, Top Energy's application in respect of the proposed 30 MW expansion of its Ngawha geothermal plant. These are being progressed as rapidly as possible but do require thorough analysis before decisions can be made.

REGULATORY ACTIVITIES

32. I now wish to outline some of the key regulatory activities that the Commission has been involved with.
33. Since the presentation at the last conference in March 2006 a lot has occurred in both the electricity lines and gas pipelines space.

Targeted Control Regime Components

34. However before describing some of the key milestones I think it is important to take a step back for a moment and remind ourselves of how the targeted control regime works. Part 4A of the Commerce Act, relating to electricity lines businesses, came into effect on 8 August 2001.
35. Part 4A encompasses a targeted control regime, and a complimentary information disclosure regime, for the 28 distribution businesses plus Transpower.
36. The targeted control and the information disclosure regimes share a common overall purpose – that is to promote the efficient operation of markets directly related to electricity distribution and transmission services.
37. The principal feature of the targeted control regime, which distinguishes it from regulatory regimes for similar companies overseas, is that none of the electricity lines businesses are automatically subject to control of their prices, revenues, and / or quality of service.
38. The Commission cannot make a declaration of control, and then authorise prices, revenues or quality, unless a lines business has breached one or more performance thresholds set by the Commission, and followed a number of subsequent steps outlined in the legislation.
39. The Commission has established two such performance thresholds to assess the lines businesses:
 - a price path threshold; and
 - a quality threshold.
40. These two thresholds are in effect until March 2009, at which time they are required to be reset by the Commission following consultation with interested parties. *I will comment more on the 2009 threshold reset later.*

What the Regime has Achieved

41. The thresholds serve a number of purposes. First they act as screening devices for the Commission to identify when lines business performance may merit further investigation.
42. The price path threshold also provides incentives for lines businesses to improve efficiency, share the benefits of efficiency gains with consumers, and to limit their ability to extract excessive profits.
43. The quality threshold encourages lines businesses to supply electricity transmission and distribution services at a quality that reflects consumer demands over time, and to not let that quality reduce while reducing prices, lowering costs and / or increasing profits.
44. To comply with the current CPI minus X price path threshold, around two-thirds of lines businesses have had to reduce their average prices in real terms over the last three years and they face further reductions over the next two years. Given current inflation rates, all businesses have been able to increase prices in nominal terms. However, limiting price increases to be less than inflation provides incentives for businesses to make efficiency gains and, over time, to share those gains with consumers.
45. A small number of businesses can increase their average prices at a greater rate than inflation without the prospect of further scrutiny from the Commission. This is because the Commission has found that some companies, while they appear to be relatively efficient, have been setting prices at a level that is not sufficient for re-investment in their networks over the longer term. The price path threshold and the Commission's operation of the regime are flexible enough to allow for Companies to operate in very different situations.
46. While the perception may be that New Zealand is moving closer to other jurisdictions' approaches to regulating electricity sector monopolies, the targeted control regime is still light-handed by international standards. It does allow companies to make their own business decisions about price, quality and investment priorities within broad boundaries of behaviour as established by the thresholds. The regime and its application are similarly broad enough to allow workable solutions to be developed without any necessity to move to control.

What happens when companies breach?

47. A breach of one or other of the thresholds does not of itself imply that a business has necessarily done something inconsistent with the legislation. It simply alerts the Commission to take a look at the circumstances of the breach and, if necessary, investigate in more depth the current and future performance of the business.
48. The Commission will investigate and on consideration of the information amassed and analysed must exercise balanced judgement that on the one hand assures New Zealand consumers that the company in question, being a natural monopoly, is not exploiting its market power; and on the other ensures that the Company is able to run its business efficiently and has the incentives to make appropriate investments. This is done by taking express account of the section 57E purpose statement and the government's policy statement issued in August 2006.
49. There are a number of options available when responding to one or more breaches of the thresholds and any additional information or evidence of behaviour that may emerge from its investigations into a breach.
50. Firstly, the Commission may decide that, following a breach and its investigation, there is sufficient information to support a decision of the Commission to take no further action, because, on balance the business may be performing in a manner consistent with the long-term benefits of its consumers.
51. Secondly, the Commission may initiate a post-breach inquiry.
52. The Commission may at any stage through this process, on the basis of an offer of administrative settlement from the business concerned, decide following public consultation that it is possible to resolve the breach through such an administrative settlement.
53. Finally the Commission upon investigating and analyzing the information gathered, may determine that it is appropriate to issue a Notice of Intention to Declare Control and thereby issue its reasons for public scrutiny and consultation by interested parties.
54. After accounting for the submissions received, the Commission must either make a determination to control or not control the services of the business in question. If the Commission decides to make a declaration, it must make a provisional authorisation under Part 5 of the Act. It then must begin a considerably more intensive process to develop final terms and the form of control.

Administrative Settlements

55. The Commission has been careful to articulate that administrative settlements may in principle and in the appropriate circumstances produce better outcomes for the long-term benefit of consumers than control.
56. Administrative settlements involve lower direct costs, administrative and compliance costs and will allow for more flexibility. They are also likely to be considerable less intrusive.
57. Each individual settlement would, however, need to result in long-term benefits to consumers that are demonstrably equal to or greater than the net benefits of control. This suggests that settlements may need to last for a number of years, and address any outstanding concerns about the business's performance that the Commission has identified as a consequence of its investigation or formal post-breach inquiry.
58. If the Commission decides that an administrative settlement is acceptable in principle, then it will consult publicly on the terms of that settlement. Apart from permitting feedback on the specific settlement terms, any public consultation process would also allow interested parties to provide their views on the Commission's proposed broader framework and processes relating to the evaluation of settlements.
59. It is important at this point to note that what would be acceptable to the Commission as part of a settlement cannot at any point be seen as a proxy for control. If the Unison consultative draft decision document settling out the Commission's reasons for accepting Unison's settlement offer in principle, in preference to control, is closely considered, what should be noted is that the administrative settlement explicitly embraces commitments by Unison that it can remain within the existing price and quality thresholds for the remainder of the current threshold period; and that it will have sufficient capital to invest in the network at a level that is in the long-term interest of consumers.
60. Therefore, the administrative settlement actually reinforces the existing threshold regime and retains the incentives of that regime.
61. The Commission has published a notice of intention to declare control for three lines businesses over the past two years.
62. A Notice of Intention was first issued with respect to the distribution services of Unison Networks in September 2005 this followed consecutive price and quality breaches; The Notice of Intention to Declare Control raised concerns about Unison's pricing levels particularly as these related to Rotorua and Taupo consumers who were not beneficiaries of Unison's

- owner, the Hawke's Bay Power Consumers' Trust and it further identified the imbalance of pricing between the three networks.
63. The Commission postponed its final decision on whether to declare control when Unison as part of a desire to offer an administrative settlement, offered to reverse previous price increases to its Rotorua and Taupo customers in March 2006. A full settlement offer was received in September 2006. The key element of the offer being Unison's proposal to lower its prices on average to comply with the Commission's price path threshold until the 31 March 2009 end of the current regulatory threshold period. Along with rebalanced tariffs between the regional networks and different customer classes.
 64. In December 2005 an intention to declare control of Transpower's transmission services was published, following threshold breaches and an announcement that prices would increase, on average, by 19% from 1 April 2006. Transpower's Board approach the Commission in late-March 2006 to indicate a desire to reach an administrative settlement with the Commission and provided an interim undertaking that effectively suspended the 19% price increase.
 65. Guidance has been provided to Transpower to assist its making a robust and comprehensive settlement offer. Transpower still has considerable work to achieve this. The Commission's expectation is that we are likely to receive a complete offer for consideration in late-March.
 66. In the meantime, Transpower late last year announced price increases for the pricing year commencing 1 April 2007. The prices announced meant that instead of a 19% price rise Transpower's customers will now only face, on average, a price increase for 2006/07 of 12.2%.
 67. Finally in July 2006 an intention to declare control of Vector's distribution services was published. This followed breaches of both price and quality thresholds and a substantial investigation revealing considerable imbalances in the levels of pricing across networks and customer classes both between and within networks.
 68. The Commission upon investigating breaches of the price and quality thresholds by Vector discovered that there were major inconsistencies between Vector's 21 different customer classes and between classes of customers located in different regions. The Commission first became generally aware of these issues in 2005. At that time Vector voluntarily undertook to address the imbalances. However, by July 2006 it was the Commission's view, due to information it had evaluated, that Vector was not going to address this issue before the reset as it had earlier indicated that it would. For instance, Vector had been earning, on average, a rate of

- return of 45% in 2004/05 from one particular class of consumers on the North Shore. By 2006/07, despite the assurance from Vector, that same class of consumers was going to provide a rate of return to Vector of 54.4% using Vector's figures.
69. Vector proposed a settlement offer to the Commission in October 2006.
 70. In each case fruitful discussions between the company and the Commission has resulted in a change in the behaviour of the particular company. In both Transpower and Unison's cases price increases were either reversed or delayed while discussion were entered into. In Vector's case, despite its current publicly announced investment freeze, it has continued to address the price imbalances.
 71. The Administrative Settlement processes to date have led to a higher level of engagement between the Commission and the particular business concerned, which in turn has led to the development of a framework for considering administrative settlements and closer relations with the particular businesses.
 72. It is the Commission's expectation that administrative settlements will become timelier in that as we move forward having developed the processes, frameworks and methodologies over the past year and the early part of this year, they will become easy to deal with.
 73. One area that has proven very successful has been at the governance and oversight level where chair-to-chair meetings on a regular basis provide clear board oversight and discipline to the processes of information sharing and guidance such that the analysis sitting behind such settlements can be progressed in as speedy a manner as possible.
 74. Settlements do need to be in a form of a deed which ensures that they are being entered into by the Chair of the respective company board and the Commission chair. This formality to the arrangement underpins the commitment of both parties.
 75. It is only once a Deed has been signed that the Commission will consider there is an agreed administrative settlement that, assuming the net benefits of the settlement offer are equal to or greater than the net benefits of control – following the public consultative process, it can publicly accept.
 76. A clear example of how well these settlement processes are working is the voluntary price rebalancing announced by Unison and the similar intention to do so announced by Vector, coupled with the considerably modified

price increases announced by Transpower. This is before any settlement agreement has been reached with any of these parties.

Information Disclosure

77. Information disclosure is intended to ensure that businesses make reliable and timely information about their operation and behaviour publicly available. This public disclosure is a vital part of the regulatory regime.
78. Information disclosure promotes a greater understanding of the relative performance of lines businesses over time. This is integral to maintaining the light-handed thresholds regime. It does so by providing information so that users can make their own assessment of company performance. It also provides the information needed for assessing compliance with the thresholds as well as for resetting the thresholds at the end of the current regulatory period.
79. The Commission is continuing a far-reaching review of the Electricity Information Disclosure Requirements that considers the fundamental question of what regulatory performance accounts should look like in the context of Part 4A, while at the same time assessing the compliance costs to lines businesses of producing disclosure information.

Asset management plans

80. A key priority for the Commission last year was the review to improve the disclosure of asset management plans, and the new requirements for these plans were released in March 2006.
81. In the Commission's view, sound asset management planning is an integral part of ensuring that, over the long-term, distribution businesses improve efficiency and provide services at a quality that reflects consumer demands. The new requirements will see businesses reporting back on actual versus planned investment and maintenance expenditure, and explaining any differences. This provides very clear information of the match of proposed investment into the network against actual investment made. It should clearly signal where constraints are impacting on the ability to undertake fieldwork over time for example. Further, the categorization of expenditure will enable assessment of the various investment requirements and their significance.

Financial Performance Disclosures

82. Further work is now being progressed on the next important area with respect to new financial information disclosures, including performance

measures such as return on investment. It is aimed for these to be determined and consulted on in the following months with an aim for final decisions to have been released by the end of June this year at which time further workshops with businesses and auditors will be held to ensure understanding of the application of the financial disclosure requirements.

83. The due date provisions will be amended to allow businesses five months from the release date in order to complete and audit their disclosures.
84. The Commission will be requiring disclosure under the new financial requirements for the year ended March 2006 to enable at least two years' worth of information to be used as an input into the 2009 threshold reset. Lines businesses will need to cooperate with the Commission on information disclosure if they wish key factors to be taken into account in the 2009 reset.

Threshold Assessments

85. A key milestone in closing a number of historic threshold breaches has been the adoption of robust methodology by the Commission to evaluate quality breaches and the factors impacting on quality, particularly extreme events. The Commission has almost completed that work and expects to be able to announce final decisions by mid year.
86. It is anticipated that with respect to a number of the current outstanding quality breaches, assuming that there are no other concerns identified by the Commission in its investigations, that gazetted decisions will be published by the end of July 2007.
87. There will also likely be a number of gazetted decisions with respect to price path breaches for a number of the companies that have breached both price and quality.

Key Issues Going Forward Threshold Reset

88. The Commission is now preparing for initial rounds of consultation on key issues relating to the 2009 reset. This consultation will commence in the second half of this year. We will be canvassing the views of interested parties as to what extent a number of issues that have arisen in implementing the regime to date should and could be taken into account in the revised thresholds from April 2009.
89. Possible incentives or disincentives provided by the regime will be a key area of focus, with possible topics including any impact of the regime on increased distributed generation and changes in the transmission / distribution boundary.
90. More generally, however, the Commission is particularly interested in views on investment incentives. Much anecdotal evidence exists regarding the burgeoning capital expenditure needs of the electricity lines sector — the so-called “wall of wire”.
91. As I mentioned earlier, the recent changes to the disclosure requirements for Asset Management Plans will help the Commission monitor the need for increased investment on a business-specific and industry-wide basis.
92. These changes, especially the requirement for businesses to explain discrepancies between planned and actual investment, will also allow the Commission to monitor whether planned investments actually proceed. Recent experience from overseas jurisdictions suggests that utilities do not always deliver on their forecast capital expenditures. The Commission intends exploring the application of possible investment incentive and accountability mechanisms in either the thresholds, or in other regulatory instruments under the targeted control regime.
93. The Commission is also interested whether the ownership arrangements of lines businesses might impact on the effectiveness and efficacy of the regime and what it is that is being achieved under part 4A. Do particular ownership structures set up particular incentives or indeed disincentives that the Commission should be aware of or concerned about when resetting the thresholds?
94. The Commission also wants to consider carefully the issue of asset roll forward and whether ODV for the asset base remains the appropriate valuation methodology.

95. The Commission is also keen to consider the integration of price and quality and how past efficiency gains should be shared with consumers. Mechanisms such as PO adjustments; glide paths and other methodologies will be considered.
96. Another interesting challenge will be the question of how to specify the thresholds at the reset to reduce the extent to which “technical” breaches (in speech marks) arise.

Cost-Reflective Pricing

97. More generally, the Commission has concerns about the level of cross-subsidies between different customer groups. This has now become a major point of focus for us given evidence that we have uncovered during some post-breach inquiries to date, as well as through the pricing methodology disclosures. Businesses that have economically unjustifiable differentials between customers have until the 2009 reset to get it sorted out, subject of course to relevant constraints that government policy places on pricing.
98. If such businesses breach in the meantime, then this is an issue we may look at closely. If a lack of cost-reflective pricing appears to remain an industry-wide concern by the time of the reset then we may need to consider whether the reset thresholds are specifically re-designed to address this issue. At this point if this is an issue for businesses that we have not investigated I would recommend urgent consideration to address the issue.
99. Finally, one of the questions we will likely traverse at the reset is whether there should be a differential between retail and large industry consumers. Is there ever a circumstance when this is warranted and if so when and in what circumstances?

GAS CONTROL

100. I now wish to focus on where the Commission has got to in its process of completing final regulatory control authorisations for the gas pipeline distribution businesses of Powerco and Vector.
101. Since provisional authorisations were issued for the businesses, the Commission has been working towards issuing a final authorisation. A discussion paper was released in early July 2006 on the form of control for consultation with interested parties. Further consultation on the form of control was carried out in August following the Government Policy Statement.

102. The Commission later held a conference in September with further cross-submissions in October. The Commission's decision with respect to the appropriate form of control will be an important part of the draft decisions paper which will be consulted on later this year.
103. The form of control will cover both price and quality issues. The final form will be consistent with the section 70A considerations in part 5, namely to promote efficiency and maximise the benefits to the acquirers of the controlled services.
104. Another of the key issues that is critical for the final decisions as to authorisation is the establishment of a robust opening regulatory asset base. The Commission recognises how important this is for the businesses and the future allowed revenue for the businesses.
105. Again the Commission is mindful of the balance that needs to be struck: Not over-inflating that opening value while also ensuring that the businesses are compensated adequately for their sunk investments.
106. The Commission has consulted extensively therefore on the asset valuation methodology that should be employed and on the schedules of replacement costs to be used in valuation of assets.
107. In October 2006 the Commission issued its decisions on asset valuation methodology. Final replacement cost decisions and full replacement cost schedules were released earlier this month. The businesses are now in the processes of completing their asset valuations in accordance with the methodologies and schedules.
108. Like the form of control issues, the valuations will be consulted on as part of the draft decisions process.

Draft Decisions Process

109. The Commission will be releasing its Draft Decisions on all aspects of the Authorisation in the coming months. Following full consultation and written submissions, the Commission will hold a conference on the Draft Decisions prior to making any final Authorisation decisions. The Authorisation is expected to be implemented in the 2007-8 pricing year.
110. Concerns have been expressed at points about the delays in completing the Authorisation process and to this I wish to make three observations.
111. Firstly, the extent of consultation required to ensure that we are adequately addressing the breadth and depth of the issues has been significant. I would suggest such consultation has been more than any of

the interested parties would have contemplated at the outset. This has resulted not only in the costs in terms of time and resource being more than anticipated but it has delayed the Authorisation outcomes. This however, is the first regulatory control Authorisation of this type under part 5 and it is important that we all work hard to ensure that the final decisions are as robust, transparent and certain as possible.

112. Secondly, and this leads on from the first point, it has been more costly than anticipated. In the gas control inquiry some estimation of the costs were considered at the time. Control has proven to be as resource intensive as estimated and then some. It would be a significant step to contemplate, for example, controlling all of the electricity distribution businesses in New Zealand. However, I must add at this point that, in the appropriate circumstances, having investigated and consulted, the Commission will not hesitate to place any deserving business under control where the net benefits of doing so outweigh the counterfactual.
113. Thirdly, from the Commission's perspective, and I suspect from the businesses' perspectives also, the Authorisation process is a considerably more intrusive process than, for example, the light-handed targeted control thresholds regime operated for the electricity lines businesses.
114. Even to the extent that, in the context of administrative settlements, we have at times sought external reviews of capital expenditure, asset management planning and operational expenditure for certain of the businesses for example, this has been at a very high level comparatively and nothing like the level of intensity of data and analysis that has been required to inform the building blocks for the gas pipelines businesses.
115. This is the first time businesses or particular services have been controlled in New Zealand. Not only have the businesses not collected or collated the necessary information in a readily accessible format for control but it is fair to say that some of the data or its form as the Commission requires will not have necessarily been a high priority for collection prior to the authorisation process commencing. The Commission has seen some improvements occurring in the quality and format of the data as we have worked with the businesses but the lack of immediate readily available data at the outset has, inevitably, impacted negatively on timelines.
116. I finally wish to make the observation that some businesses have stated that the regulatory regimes are uncertain in New Zealand and they cannot predict what regulatory control in New Zealand would mean. To those businesses I would recommend that they pay closer attention to the gas control Authorisation process and the decisions that have and will be made in that context. The control Authorisation for the gas pipelines

business will provide very good signals of how the Commission would proceed in any Part 5 Authorisation.

Cost of Capital Guidelines

117. In October 2005 the Commission commenced a review of its current approach to estimating firms' cost of capital, which is an important input into most of regulatory decisions. The purpose of the review is to formalise the key principles underlying the Commission's methodology to cost of capital estimation in order to provide industry participants with greater clarity on the Commission's regulatory approach.
118. The review process began with the public consultative process on the Commission's Draft Cost of Capital Guidelines. Several detailed submissions were received on the Draft Guidelines. These submissions raised a broad range of issues, some of them complex, relating to the Commission's present methodology, which needed to be assessed carefully. To this end, and in line with suggestions made by some submitters, the Commission appointed a panel of three experts -- one from the UK (Prof. Julian Franks), one from the US (Prof. Stewart Myers), and one from New Zealand (Dr. Martin Lally) -- to review the Draft Guidelines and submissions, and provide advice to the Commerce Commission. The panel is currently preparing its recommendations to the Commission.
119. Taking into account the panel's advice, the Commission will exercise its own judgment to reach decisions, hopefully towards mid-2007, to enable the formulation and publication of Final Guidelines, which will apply across all regulatory functions. The guidelines will provide a consistent framework that the Commission will employ to estimate the cost of capital. In applying these Guidelines, the Commission will use them as a starting point, and adapt them when necessary to accommodate variations in industry-and firm-specific circumstances.

CONCLUSION

120. The energy sector continues to be a high priority for the Commerce Commission. The Commission recognizes that efficient electricity and gas markets are essential for New Zealand's economic performance.
121. A most critical issue looking forward is ensuring that there is adequate investment at the right time to ensure that the levels of maintenance and innovation are maintained in the industry to meet demand and the long-term interests of consumers.
122. It is the Commission's view that regulatory regimes must facilitate investment and that consumers can be confident that, particularly in the

- absence of competitive pressure, investments that are planned, are made and that they are made efficiently. Similarly they must be priced appropriately and be subject to public scrutiny.
123. This will be one of the key issues confronting the threshold reset and is a key issue that will be carefully considered in the Authorisation for the gas pipelines businesses.
 124. Regulation is often criticized in New Zealand and elsewhere, as being a barrier to investment. However it is very important to note that unregulated monopoly businesses will not always choose to make the necessary investments. It is becoming clearer that New Zealand's electricity sector, particularly its network businesses, have "pent up" investment needs for what is becoming critical investment primarily due to the necessary levels of appropriate investment not being made in the past.
 125. An effective regulator will not be swayed by unsubstantiated claims that regulation is discouraging or indeed stifling investment. The Commission is aware that as the economic regulator we have an important role to ensure a regime that enables investment to occur which is efficient, transparent and above all meets the long term needs of consumers.
 126. In consultation with industry and other stakeholders we will continue to refine the regime so that the best outcomes can be achieved. The Commission will continue to maintain its Independence and require that submissions on investment are substantiated by robust submissions supported by strong analysis.
 127. We of course have a much broader role than industry-specific regulation and as noted at the commencement of this presentation we have a broader tool kit to address market issues at our disposal. Where there are market structure or competition issues identified the Commission will not hesitate to take Commerce Act investigations where necessary.
 128. If consumers do not receive accurate or reliable information to make informed choices the Commission similarly will investigate under the Fair Trading Act.
 129. It is through the application of these tools that the Commission can assist to ensure that New Zealand energy markets are dynamic, competitive and deliver the electricity and gas that is vital to the welfare of New Zealand's industrial, commercial and residential consumers.

Thank you for your time today.