

# **TRANSMISSION PRICING ADVISORY GROUP**

**17 June 2004**

## **Advisory Groups: The Legal Framework**

This paper outlines the legal and regulatory framework governing rule-making under the Electricity Act with particular emphasis on the role of the Electricity Commission's Advisory Groups within that framework.

## Introduction

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### **Purpose of paper**

This paper was requested by the Electricity Commission (the 'Commission'). Its purpose is to provide the Commission with a background paper for use in its induction of Advisory Group members. The paper sets out the legal and regulatory framework governing rule-making under the Electricity Act 1992 (the 'Electricity Act' - the primary governing legislation) with particular emphasis on the role of the Commission's Advisory Groups.

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### **Draft Government Policy Statement and working groups**

The draft Government Policy Statement (GPS) dated 14 September 2003 stated that the Government expected the Commission to make extensive use of working groups to develop market arrangements and make recommendations concerning regulations and rules. The GPS further noted that working groups should have the necessary expertise and be appropriately representative of affected parties.

Additionally, the GPS noted that the Electricity Act required the Commission to consult with representatives of parties it thinks are likely to be substantially affected before making recommendations concerning regulations and rules. The Government considers it important that good process is followed in the development and recommendation of regulations and rules.

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### **Commission responds by establishing Advisory Groups**

In early March 2004 the Commission called for nominations for a series of Advisory Groups. The Advisory Groups are the equivalent of the market working groups used by the industry prior to the regulation of the market. The use of the phrase "Advisory Groups" rather than "Working Groups" is deliberate and reflects the differing role and powers of these groups in the light of the new rule-making process under the Electricity Governance Regulations 2003 ('EGRs').

The Commission's decision to establish Advisory Groups meets the desire expressed by the Government in the GPS.

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## The Legal Framework

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### **A three-tiered legal framework**

The Government has chosen to introduce a three-tiered legal framework to regulate New Zealand's electricity markets. This legal framework is additional to generic law such as the Commerce Act 1986 and the Electricity Industry Reform Act 1998 which continue to apply to market participants.

The tiered structure is as follows:

- **Primary legislation** – the governing statute is the Electricity Act (as amended by the Electricity Amendment Act 2001). This statute establishes the Commission and confers the necessary legal authority to make regulations and rules to govern the industry. Statutes can only be amended by a further Act of Parliament;
- **Secondary legislation** – The EGRs that came into force on 16 January 2004 were made under the authority of the Electricity Act 1992. Those regulations establish the governance framework for the market. Secondary legislation may be altered by the Executive Council (the Governor-General and Cabinet) but only in a manner authorised by the governing statute; and
- **Tertiary legislation** – The final limb of the legal framework is the Electricity Governance Rules, which came into effect on 1 March 2004 (with the exception of Part F). Those rules stipulate the day-to-day operational rules of the market. The Minister makes the rules on the recommendation of the Commission. In terms of interpretation, if there is a conflict between the rules and regulations, the regulations take precedence.

With the exception of reference to the Code of Practice D5 Review Panel, each tier of this legal framework is silent as to the existence, role, and powers of Advisory Groups (or working groups).

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### **The legal framework and the GPS**

Section 172X of the Amendment Act requires the Commission, amongst other things, to ensure that its recommendations are consistent with any direction it has been given under section 172ZA. That section gives the Minister of Energy the power to direct the Commission on the outcomes or objectives to be achieved as set out in the statement of government policy.

Section 172ZK requires the Minister of Energy to set objectives and outcomes that the Government wants the Commission to pursue in relation to the governance of the electricity industry.

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## The Legal Framework, Continued

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### **The Electricity and Gas Industries Bill**

While this Bill is yet to become a formal part of the legislative framework,<sup>1</sup> its likelihood of passage into law warrants specific mention.

The Bill reflects the establishment of the Commission and updates terms in the present Electricity Act 1992 to take account of this. However, more importantly, it provides for the Commission to endeavour to ensure that New Zealand's electricity supply is secure, with adequate reserve energy for dry years. Additional powers, including regulation-making powers, are provided to enable the Commission to carry out this responsibility. These include amending the Electricity Act 1992 to allow the Electricity Commission to contract for reserve energy supplies and amending the Electricity Industry Reform Act 1998 to allow lines companies to own reserve generation without limit and ordinary generation up to 25 megawatts, or 10% of their load.

The Bill also contains enhanced regulation-making powers in the following areas:

- (i) to facilitate and promote retail competition;
  - (ii) to improve the provision of information for market participants;
  - (iii) to improve the operation of hedge and contract markets;
  - (iv) to facilitate the development of distributed generation; and
  - (v) to protect and empower consumers.
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<sup>1</sup> The Bill was introduced into the House on 28 October 2003 and given its First Reading on 6 November 2003.

## Regulatory Agencies

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### **The Minister of Energy**

The Minister of Energy holds the highest position in the hierarchy. The Minister decides whether to recommend a change to the EGRs to the Cabinet and has final decision rights on changes to the rules.

The Minister must have regard to the Commission's recommendations, but is open to not accept the advice. However, he or she must have a reason for making any decision and must make that reason known (see section 172Z of the Amendment Act). This regime differs to that which operates under the Commerce Act, for example, where the Commerce Commission is independent of the political process.

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## Regulatory Agencies, Continued

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### **Electricity Commission**

In the context of the regulatory framework, the Commission's role is to provide the Minister with enough information to make a proper and considered decision either to recommend to Cabinet that new regulations be promulgated, or to make a new market rule. The Commission is the primary (but not sole) vehicle by which the Minister receives advice on the development of market regulations and rules.<sup>2</sup> It is, however, the body that will ultimately determine what advice and recommendations are transmitted from the Advisory Groups to the Minister of Energy. It is assisted in this task by its staff, the Advisory Groups, service providers and external advisors.

The principal objective of the Commission is set out in section 172N of the Amendment Act. The principal objective of the Commission is to:

*"ensure that electricity is generated, conveyed, and supplied to all classes of consumers in an efficient, fair reliable and environmentally sustainable manner."*

In performing its functions, the Commission must promote its principal objective (above) and must have regard to the objectives set out in section 172E (2)(c) which are:

- (i) energy and other resources are used efficiently;
- (ii) risks relating to security of supply are properly and efficiently managed;
- (iii) the full costs of producing and transporting each additional unit of electricity are signalled;
- (iv) delivered electricity costs and prices are subject to downward pressure;
- (v) the quality of electricity services, as far as possible, reflects customers' preferences;
- (vi) transmission losses and constraints are signalled; and
- (vii) consistency with the Government's climate change policies and objectives is achieved.

The Commission will be judged on the degree to which it meets its objectives specified in the Electricity Act and those set out in the GPS.

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<sup>2</sup> The Minister will also get advice from other agencies of state (see the following sections), in addition to any other person or company that may wish to submit advice direct to him.

## Regulatory Agencies, Continued

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### **Ministry of Economic Development**

As a department of state with responsibility for energy policy generally and the Electricity Act in particular, the Ministry of Economic Development (MED) has an ongoing role in the policy formulation process. It will develop the GPS on behalf of its Minister, and will also be the department responsible for monitoring oversight of the Commission as a Crown entity (it performs this function for many Crown entities e.g. the Commerce Commission).

Given MED's overall responsibility for the development and maintenance of the energy policy regulatory framework within which the Commission operates, the Commission and Advisory Groups should expect MED to review and critique recommendations to the Minister. MED will continue to have the ability to directly advise the Minister on these matters.

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### **Other Departments**

Because of the unavoidable economic effects of the Commission's recommendations on regulations and rules, other departments in addition to MED, will have an on-going interest in the Commission's work.

With respect to regulations, the chief of those is The Treasury, but agencies such as the Energy Efficiency and Conservation Authority (EECA) and the Ministry for the Environment who have an interest in the development of energy policy, will also have a role and an ability to directly advise their respective Ministers on the Commission's recommendations. These agencies will automatically get to review proposed changes to regulations as they proceed through the Cabinet decision-making process.

All other agencies will be able to participate in the consultation process required for changes to the rules.

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## The Role of Advisory Groups

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### **Charter on Advisory Groups**

Recognising the lack of detail concerning Advisory Groups, the Commission has published a Charter on Advisory Groups (the Charter for the Transmission Pricing Advisory Group is the next item on the agenda).

The Charter sets out the structure and role of the Advisory Groups. The Charter makes it clear that whilst Advisory Groups can only assist the Commission in the proper and efficient discharge of its statutory responsibilities and duties, they cannot relieve the Commission of these legal responsibilities. Accordingly, the Advisory Groups' role by law must be confined to the provision of advice. There is no obligation whatsoever on the Commission to follow that advice.

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### **Specific role of Advisory Groups**

More specifically, Advisory Groups are intended to support the fulfilment of the Commission's obligation to the Minister - to provide the Minister with enough information to make a proper and considered decision in relation to regulations or rules. Therefore, the role of the Advisory Group is to undertake sufficient analysis and provide robust information to the Commission to enable it to make credible, workable recommendations.

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### **Relationship to Senior Advisors**

The Commission's Senior Advisors are accountable to the Commission for the quality and timeliness of the output from the Advisory Groups. As the Advisory Groups, in a practical sense, will be responsible for the actual delivery of the majority of the outputs, a close and strong working relationship is required between the Advisory Group (specifically the Chair), the Senior Advisor and the relevant Advisory Group Administrator.

Regular reports to the Commission on the progress of the Advisory Groups against their allocated workstreams will be required.

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### **Factors to be considered by Advisory Groups**

In addition to the analysis of the problem being addressed with recommendations as appropriate, the Advisory Groups should take the following four factors into consideration:

- (i) affected parties;
- (ii) the Commission's objectives;
- (iii) consultation undertaken; and
- (iv) cost.

Each of these is briefly canvassed in the following sections.

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## The Role of Advisory Groups, Continued

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### **Affected parties**

The scope of the Commission's responsibilities is broader than existed under the private industry arrangements. Advisory Groups should specifically consider who is primarily affected (both negatively and positively) by the proposal the Advisory Group has under review.

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### **Assessment against objectives**

Industry participants may be familiar with the concept of guiding principles and the use that guiding principles were put to when justifying changes to market rules. While no longer relevant, Advisory Groups should adopt a similar process when preparing recommendations to the Commission save that the Commission's objectives (statute and GPS) will supplant guiding principles as the measuring stick.

In practice, this will mean including a separately identifiable section in each report that directly addresses:

- (i) how the proposal promotes the Commission's principal objective;
- (ii) what regard was given to the Commission's objectives as set out in section 172E (2)(c); and
- (iii) how the proposal relates to the requirements of the GPS.

Where trade-offs between objectives are made in reaching a recommendation (such as could possibly be made between efficiency and environmental sustainability), this should be highlighted and explained, with reasons given for the recommendation that that Group makes.

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## The Role of Advisory Groups, Continued

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### **Developmental and consultative role**

Advisory Groups not only assist the Commission to prepare policy and operational changes that are prudent and proper but also advises it on its obligations with respect to consultation.

With respect to the latter, it is expected that the output of Advisory Groups will be a document that will include a set of proposed regulatory or rule changes to be consulted on. It would, therefore, be helpful for Advisory Groups to include an explicit section outlining who has been consulted in the preparation of its reports (this may vary from simply the Advisory Group members themselves and the MED, through to a broader group as considered appropriate by the Advisory Group, such as service providers) and the extent and form of any further consultation necessary to enable the Commission to fulfil its statutory obligations.<sup>3</sup>

Such advice cannot, in any way, replace the Commission's legislative requirement to undertake consultation. However, it is appropriate for the Advisory Group to inform the Commission who has been consulted in the preparation of its advice (as an indicator of its robustness), as well as its views on the extent and form of any further consultation, given its intimate knowledge of the issue, its significance, potential constituency of interest and how best to engage them.

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### **Cost/benefit analysis**

It is critical that the costs associated with the implementation of the proposed rule change are thoroughly assessed against the benefits of the proposal so that each proposal stands on the merits of its net benefits to the sector.

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<sup>3</sup> Section 172G(2)(b) states that "before making a recommendation, EGB must consult with persons that EGB thinks are representative of the interests of the persons likely to be substantially affected by the proposed regulations."

## Summary

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### **Summary snapshot**

This paper places the Advisory Groups into the broader legislative framework within which they operate. Advisory Groups are a tool of the Commission and have been established to meet the desire expressed by the Government in the GPS.

The paper also sets out the roles of the Advisory Groups, with particular emphasis on how they can support the fulfilment of the Commission's obligations to the Minister of Energy.

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