

# Review of two aspects of the customer compensation scheme

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## Consultation paper

20 February 2018



## Executive summary

The Electricity Authority (Authority) has considered two potential issues with the customer compensation scheme (CCS) arrangements in Part 9 of the Electricity Industry Participation Code (Code). We believe only one of these is, in fact, a problem. To address this, we propose amending the Code to require electricity retailers to pay qualifying customers only for the time they supply those qualifying customers during a public conservation period (PCP).

### **Matter 1: Should a retailer compensate a qualifying customer for all of a PCP even if it supplies the customer for only part of the PCP?**

Currently, retailers that must pay compensation during a PCP (CCS providers) must pay those customers who meet the Code's definition of 'qualifying customer'. A requirement for being a qualifying customer is being a customer of the CCS provider at the end of the last day of the PCP. This requirement means the CCS provider must compensate its qualifying customers for every day of a PCP, regardless of whether a qualifying customer has been the CCS provider's customer for all of the PCP. We consider this hinders retail competition and the efficient operation of the electricity industry, thereby limiting the economic benefits of the CCS arrangements in the Code.

We propose amending the Code to require a CCS provider to compensate a qualifying customer only for the days during a PCP that the CCS provider supplied the qualifying customer. This change would make the CCS arrangements in the Code non-distortionary in respect to their effect on retail competition. We expect this would:

- (a) promote retail competition, thereby furthering the competition limb of our statutory objective
- (b) promote the efficient operation of the electricity industry, which would further the efficiency limb of our statutory objective.

In section 3 of the paper we have prepared a regulatory statement for the proposed Code amendment. We believe the qualitative benefits from proceeding with the Code amendment would be larger than the quantified costs.

### **Matter 2: Should the Authority review the minimum weekly amount more, or less, frequently than every three years?**

We have also considered whether there is a problem with the Code requiring the Authority to review, at least once every three years, the minimum weekly amount (MWA) paid to qualifying customers when there is a PCP. Currently, the MWA is set at \$10.50 per week during a PCP. We have reviewed the MWA every three years since introducing the CCS, which is the maximum period permitted under the Code.

We have concluded that amending the Code to put in place a different timeframe for reviewing the MWA is not justified. However, we will review the MWA before each scheduled three yearly review, if a change to any of the key inputs used to calculate the MWA meant the MWA would be likely to materially change. This meets a fundamental design principle for the MWA, which is that the MWA should be approximately cost-neutral to CCS providers.

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# 1 What you need to know to make a submission

## What this consultation paper is about

- 1.1 The purpose of this paper is to consult with interested parties on the Authority's proposal to amend the Code to require an electricity retailer to pay compensation to a qualifying customer only for the days the retailer supplies the customer during a PCP.
- 1.2 We believe this amendment would better align the CCS arrangements in the Code with our statutory objective, by promoting competition in, and the efficient operation of, the electricity industry.

## How to make a submission

- 1.3 Our preference is to receive submissions in electronic format (Microsoft Word) in the format shown in Appendix B. Submissions in electronic form should be emailed to [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz) with "Consultation Paper—Review of two aspects of the customer compensation scheme" in the subject line.
- 1.4 If you cannot send your submission electronically, post one hard copy to either of the addresses below, or fax it to 04 460 8879.

### Postal address

Submissions  
Electricity Authority  
PO Box 10041  
Wellington 6143

### Physical address

Submissions  
Electricity Authority  
Level 7, ASB Bank Tower  
2 Hunter Street  
Wellington

- 1.5 Please note we want to publish all submissions we receive. If you consider that we should not publish any part of your submission, please:
  - (a) indicate which part should not be published
  - (b) explain why you consider we should not publish that part
  - (c) provide a version of your submission that we can publish (if we agree not to publish your full submission).
- 1.6 If you indicate there is part of your submission that should not be published, we will discuss with you before deciding whether to not publish that part of your submission.
- 1.7 However, please note that all submissions we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we did not publish unless good reason existed under the Official Information Act to withhold it. We would normally consult with you before releasing any material that you said should not be published.

## When to make a submission

- 1.8 Please deliver your submissions by **5pm** on Tuesday **10 April 2018**.
- 1.9 We will acknowledge receipt of all submissions electronically. Please contact the Submissions' Administrator if you do not receive electronic acknowledgement of your submission within two business days.

## 2 We have analysed two possible issues with the CCS arrangements in the Code

### **The Code requires electricity retailers to pay qualifying customers during a PCP**

- 2.1 The Code requires electricity retailers to pay their qualifying customers during a PCP.<sup>1</sup> A PCP is a period during which:
- (a) the system operator has commenced an official conservation campaign (OCC) to encourage electricity conservation, and this campaign has lasted for one week or more; or
  - (b) a supply shortage declaration made by the system operator has been in force for one week or more.<sup>2</sup>
- 2.2 The Code refers to the arrangement under which a retailer pays its qualifying customers during a PCP as a CCS. Under clause 9.21 of the Code, a customer of an electricity retailer qualifies for compensation under a CCS (is a qualifying customer) if, as at the end of the last day of the PCP:
- (a) the customer has a contract with the retailer for the supply of electricity in respect of an ICP<sup>3</sup> at which:
    - (i) there is a category 1 metering installation or a category 2 metering installation<sup>4</sup>
    - (ii) there was consumption, in the 12 months immediately before the start of the PCP, of 3,000 kilowatt hours (kWh) or more
  - (b) the price of some, or all, of the electricity provided under the customer's contract with the retailer for the supply of electricity is not determined by reference to the final price at a grid exit point (GXP).<sup>5</sup>
- 2.3 The Code describes a default CCS for retailers to use, but permits retailers to develop one or more additional CCSs. A qualifying customer can choose between the default CCS and any additional CCS their retailer offers.
- 2.4 A retailer must pay a qualifying customer for a PCP only if the retailer is recorded in the registry as the trader responsible for the ICP at which the qualifying customer is supplied electricity. When this requirement was introduced, the rationale was that a retailer listed in the registry would ordinarily buy electricity at the spot price and sell this electricity at a price containing some fixed price variable volume (FPVV) component. These retailers were the parties the CCS arrangements were designed to cover. In this paper we refer to

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<sup>1</sup> Refer to clause 9.22 of the Code.

<sup>2</sup> While a supply shortage declaration is in force, the system operator may direct specified participants to assist in reducing consumption of electricity by implementing power outages or some other action.

<sup>3</sup> A consumer's point of connection to an electricity network.

<sup>4</sup> The vast majority of residential and small non-residential consumers in New Zealand are supplied electricity using category 1 metering installations.

<sup>5</sup> In other words, the consumer is not eligible to receive compensation if the price of all of the electricity provided by the retailer is determined by reference to the final price at a GXP (that is, by reference to the spot price).

these retailers as 'CCS providers'. This is to differentiate them from those retailers not recorded in the registry as being responsible for the qualifying customer's ICP.<sup>6</sup>

**The Authority has established a project to consider possible issues with the CCS arrangements**

- 2.5 We established a project to look at a set of possible issues with the CCS arrangements. This project stems from our review of the CCS arrangements in 2016-17 and submissions on the CCS consultation paper we published as part of that review.<sup>7</sup>
- 2.6 Our initial focus is on whether we should change the following two aspects of the CCS arrangements:
- (a) the requirement for a CCS provider to compensate a qualifying customer for the entire PCP, as long as the qualifying customer is a customer of the CCS provider at the end of the last day of the PCP
  - (b) our approach of reviewing the MWA every three years, which is the maximum time period permitted under the Code.

**Matter 1: Should a CCS provider compensate a qualifying customer for all of a PCP even if it supplies the customer for only part of the PCP?**

- 2.7 Under clause 9.24 of the Code, a CCS provider must, under its default CCS, pay compensation to a customer for the entire period of a PCP, if the customer is a qualifying customer. The Code requires only that the qualifying customer is the CCS provider's customer at the end of the last day of the PCP.
- 2.8 This requirement has the benefit of transactional simplicity:
- (a) A CCS provider only has to determine its qualifying customers at a single point in time. It does not need to track which customers join or leave during a PCP.
  - (b) Consumers following up on compensation payments only need to interact with one retailer.
- 2.9 However, the following outcomes could arise under this market design:
- (a) Retailers that are CCS providers might be more reluctant, or less able, to accept new qualifying customers during a PCP—especially during the latter stages of a PCP. This would stem from the financial burden associated with paying compensation to a new qualifying customer for days during the PCP when the CCS provider was not the customer's electricity retailer.
  - (b) Consumers not eligible for compensation because they purchase electricity at a price based on spot prices may switch to a FPVV contract (either with the same CCS provider or with another CCS provider) near, or at, the end of a PCP, so they become entitled to compensation for the entire PCP.
  - (c) CCS providers may seek to recover the cost of paying a qualifying customer for days during a PCP when the CCS provider was not supplying the customer (or the customer was on a spot price contract with the CCS provider).

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<sup>6</sup> The registry does not record all electricity retailers, only those that are traders.

<sup>7</sup> The consultation paper and decision paper on the review of the CCS arrangements in the Code are available at [www.ea.govt.nz/dmsdocument/21363](http://www.ea.govt.nz/dmsdocument/21363) and [www.ea.govt.nz/dmsdocument/22575](http://www.ea.govt.nz/dmsdocument/22575).

- (d) CCS providers may face an increased incentive to lose customers nearer the end of the PCP, to avoid paying compensation (eg, by increasing prices, moving qualifying customers to a higher-priced plan or to a price based on the spot price).<sup>8</sup>
- 2.10 The first outcome would be inconsistent with our objective of promoting competition in the electricity industry.
- 2.11 The second outcome (paragraph 2.9(b)) would be inconsistent with our objective of promoting the efficient operation of the electricity industry. This outcome would be inconsistent with the fundamental design principle that the MWA should be approximately cost-neutral to CCS providers (ie, the MWA should, on average, approximate the benefit to CCS providers from electricity savings made by their qualifying customers during an OCC).
- 2.12 Under the second outcome, the MWA paid to the qualifying customer would most likely exceed the estimated benefit to the CCS provider from electricity savings made by the qualifying customer during the OCC. This is because the CCS provider would not benefit from purchasing less electricity at the spot price for the period of time during the OCC when the customer purchased electricity at the spot price.
- 2.13 The third outcome (paragraph 2.9(c)) would most likely be inconsistent with our objective of promoting the efficient operation of the electricity industry. The CCS provider would be likely to under- or over-recover the MWA paid for the period when the customer was not a qualifying customer of the CCS provider. This would make it less likely that the MWA paid to the customer was cost-neutral to the CCS provider.
- 2.14 The fourth outcome (paragraph 2.9(d)) may be inconsistent with our objective of promoting reliable supply by, and the efficient operation of, the electricity industry. Qualifying customers might face a higher risk of being without a retailer on the last day of the PCP, which would affect not only their electricity supply but also their entitlement to compensation.

**We believe an element of the current approach to determining whether a CCS provider must pay qualifying customers hinders competition and efficiency**

- 2.15 The design of the default CCS requires a CCS provider to pay a qualifying customer for the entire PCP, regardless of whether the CCS provider supplied the customer for the entire PCP. Based on the assessment in paragraphs 2.7 to 2.14, we consider this design element of the default CCS adversely affects competition in, and the efficient operation of, the electricity industry. It may also affect reliable supply by the electricity industry.

**Amending the Code to require CCS providers to pay a qualifying customer only when supplying the qualifying customer would improve competition and efficiency**

- 2.16 We propose amending the Code to require a CCS provider to compensate a qualifying customer during a PCP only for the days during the PCP when the CCS provider supplied the qualifying customer. This would better promote competition in the supply of electricity to qualifying customers. It would remove the incentive on a CCS provider to not gain customers during a PCP, to avoid paying compensation to them for the days during the PCP when they were not the CCS provider's customer.

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<sup>8</sup> A CCS provider may, for example, give 30 days' notice of a price change at the beginning of a PCP, under the assumption the PCP would last for at least one month.



- 2.17 We expect the proposed Code amendment would also improve the efficient operation of the electricity industry by:
- (a) removing cross-subsidies between CCS providers
  - (b) removing the incentive for CCS providers to seek to recover the cost of paying a qualifying customer for days during a PCP when another CCS provider supplied the customer, or the customer was on a spot price contract with the CCS provider
  - (c) providing for the MWA to be approximately cost-neutral to CCS providers.
- 2.18 We have identified a number of expected costs associated with the proposed Code amendment. Key costs include:
- (a) possible changes to CCS providers' systems and/or processes and procedures
  - (b) a potentially higher probability of some qualifying customers:
    - (i) mistakenly not receiving compensation
    - (ii) receiving the wrong amount of compensation
    - (iii) mistakenly receiving compensation from more than the correct number of CCS providers.
- 2.19 We have concluded the expected benefits of the proposed Code amendment are likely to outweigh its expected costs. The regulatory statement in section 3 discusses the expected benefits and costs of the proposed Code amendment more fully.
- 2.20 Finally, we note a consequential effect of our proposal is that a person would no longer miss out on compensation just because they were not supplied at an ICP at the end of the last day of PCP (even though they were supplied at the ICP for other days during the PCP). This outcome results from now linking a CCS provider's payment liability to a period of time, rather than to a point in time.<sup>9</sup>

**Q1. Do you agree there are adverse effects on retail competition and market efficiency from a retailer having to compensate a qualifying customer for all of a PCP regardless of whether the retailer supplies the qualifying customer for all of the PCP?**

**Q2. Do you agree with our proposed approach to addressing these adverse effects?**

## Matter 2: Should the Authority review the MWA more, or less, frequently than every three years?

- 2.21 Currently, we review the MWA of the default compensation scheme once every three years. This is the maximum time permitted under the Code.<sup>10</sup> When undertaking these reviews, we use the following key inputs to calculate the MWA:
- (a) the estimated average electricity consumption during the winter quarter of residential and smaller commercial consumers on FPVV contracts<sup>11</sup>
  - (b) the estimated average electricity savings rate of residential and commercial consumers on FPVV contracts during an OCC

<sup>9</sup> Refer to clause 9.21(4)(a).

<sup>10</sup> Refer to clause 9.25.

<sup>11</sup> We use category 1 and category 2 metering installation numbers from the registry as a proxy for the number of these consumers.



- (c) the estimated average spot electricity price that retailers would pay in the absence of an OCC
  - (d) the estimated energy cost embedded in retailers' FPVV electricity tariffs.
- 2.22 These key inputs could materially change over time—both over a longer period, such as three or more years, and over a shorter period, such as within a year. Examples of how this might come about include:
- (a) changes in New Zealand's hydrology could materially affect electricity hedge prices, both within a year and over a couple of years, thereby affecting our estimate of the energy cost embedded in retailers' FPVV electricity tariffs
  - (b) technological change could, over several years, materially alter electricity consumption.
- 2.23 As noted above, a fundamental design principle for the MWA is that it should be approximately cost-neutral to CCS providers. That is, a CCS provider is simply passing to its qualifying customers the economic benefit it receives from their electricity conservation efforts during an OCC. This is consistent with our objective of promoting the efficient operation of the electricity industry.
- 2.24 To meet this design principle, we should review the MWA in a timely manner if a material change to the MWA was likely because of a change to a key input used to calculate it. A review of the MWA every three years would not be sufficiently timely if this situation occurred, for example, within a year or two of the last review.<sup>12</sup>
- 2.25 However, the current CCS arrangements in the Code do not prevent us reviewing the MWA more often than every three years. We would review the MWA more frequently if changes to the key inputs to calculating the MWA were to change sufficiently to make it likely that the MWA would materially change.
- 2.26 On the other hand, the current CCS arrangements in the Code prevent us reviewing the MWA less often than every three years. Less frequent reviews would reduce cost, thereby promoting the efficient operation of the electricity industry, if the MWA calculation inputs were relatively static over a period longer than three years. We anticipate evolution in the electricity industry in coming years means we may review the MWA more frequently than every three years, rather than less frequently. Therefore, we consider that changing to a longer review cycle would not be warranted, as it would be unlikely to promote the efficient operation of the electricity industry.

**We consider the current requirement for the Authority to review the MWA at least once every three years is appropriate**

- 2.27 Based on the assessment in paragraphs 2.21 to 2.26, we consider the current requirement for the Authority to review the MWA at least once every three years is appropriate. We have not identified alternatives that would better promote the Authority's statutory objective than the current arrangements in the Code.

**Q3. Do you agree the current requirement for the Authority to review the MWA at least once every three years is appropriate?**

<sup>12</sup> The probability of input information materially changing near the end of a three-yearly review cycle, thereby resulting in a timely review of the MWA under the next review, is low.

### 3 Regulatory statement

- 3.1 Sections 39(1)(b) and (c) of the Electricity Industry Act 2010 (Act) require the Authority to prepare and publish a regulatory statement on any proposed amendment to the Code, and to consult on the proposed amendment and regulatory statement.
- 3.2 Section 39(2) of the Act provides that the regulatory statement must include:
- (a) a statement of the objectives of the proposed amendment
  - (b) an evaluation of the costs and benefits of the proposed amendment
  - (c) an evaluation of alternative means of achieving the objectives of the proposed amendment.
- 3.3 This section contains the regulatory statement for a proposed Code amendment (the proposal) that would require a CCS provider to compensate a qualifying customer for each day of the PCP that the CCS provider supplied the qualifying customer.

#### **The proposal's objective is to improve retail competition**

- 3.4 The primary objective of the proposed Code amendment would be to improve retail competition during a PCP. This would be achieved by removing the distortionary effect on retail competition stemming from the element of the default CCS design referred to in paragraph 2.7.
- 3.5 This would further the competition limb of the Authority's statutory objective.

#### **Q4. Do you agree with the proposal's objective? If not, why not?**

#### **We have analysed the proposal's benefits and costs**

- 3.6 We have assessed the proposal's expected benefits and costs, using a combination of qualitative and quantitative analysis. We have compared the proposal against the current arrangement in the Code (the status quo).

#### **We have undertaken a qualitative assessment of the proposal's benefits**

- 3.7 The proposal's primary benefit, compared with the status quo, would be to promote competition in the supply of electricity to qualifying customers. It would do this by removing the incentive on a CCS provider to not gain customers during a PCP in order to avoid paying compensation to them for the days during the PCP when they were not the CCS provider's qualifying customer.
- 3.8 We have not quantified the economic benefit from improved retail competition under the proposal, due to the uncertainty of the numbers that we would use in that analysis. However, we believe the benefit would be material because of the important role that retail competition has in promoting dynamic economic efficiency in the electricity industry.<sup>13</sup>

<sup>13</sup> Dynamic efficiency is achieved by firms having appropriate (efficient) incentives to innovate and invest in new products and services over time. This increases their productivity, including through developing new processes and business models, and lowers the relative cost of products and services over time.

- 3.9 We expect the proposal would also improve the efficient operation of the electricity industry:
- (a) It would remove cross-subsidies between CCS providers—when a CCS provider compensated a customer for days during a PCP when another CCS provider supplied the customer. Since cross-subsidies between each pairing of CCS provider would be unlikely to sum to zero, these cross-subsidies would represent wealth transfers between CCS providers. The wealth transfers might distort CCS providers' economic decision-making, which would have a negative effect on the efficient operation of the electricity industry. The cross-subsidies would also contribute to the MWA not being cost-neutral to a CCS provider, for the reason set out in paragraph 2.12.
  - (b) It would remove compensation payments to consumers who were on FPVV contracts at the end of the last day of the PCP, but who were on spot price-based contracts earlier in the PCP. As discussed in paragraphs 2.11 and 2.12, this would be inconsistent with the MWA being approximately cost-neutral to CCS providers.
  - (c) It would remove the probability of CCS providers seeking to recover the cost of paying a qualifying customer for the days during a PCP when the CCS provider did not supply the qualifying customer. As discussed in paragraph 2.13, removing this probability would help facilitate the MWA being approximately cost-neutral to CCS providers.
- 3.10 We consider that, on balance, the proposal would have a negligible effect on promoting reliable supply. The proposal may reduce the incentive for some CCS providers to lose customers towards the end of a PCP. However, for other CCS providers, it may simply move this incentive forward, depending on the CCS provider's financial circumstances.

**We have undertaken a partial quantitative assessment of the proposal's costs**

- 3.11 We believe the proposal would have the following key costs:
- (a) Some CCS providers may want, or need, to change their systems and/or processes and procedures to accommodate the proposal (eg, to track the number of days they supply each of their qualifying customers during a PCP).
  - (b) Compared with the status quo, there would be a higher probability of some qualifying customers:
    - (i) mistakenly not receiving compensation
    - (ii) receiving the wrong amount of compensation
    - (iii) mistakenly receiving compensation from more than the correct number of CCS providers.
- 3.12 We believe these key costs would not be significant, for the following reasons:
- (a) The proposal does not impose a specific method by which CCS providers must compensate their qualifying customers. We expect CCS providers would be likely to use the same methods to pay compensation to customers under the proposal as they would under the status quo (eg, crediting customers' invoices). CCS providers should also be able to use existing data to readily determine the number of days they must pay compensation to a qualifying customer (eg, using ICP days or the data used for calculating daily line charges on customer invoices). Therefore, we

anticipate that CCS providers are likely to only incur costs related to updating their processes and procedures, not their systems.

- (b) Customers are seldom billed twice, or not billed at all, when switching retailers. We see no reason why customer compensation payments should be any different. Therefore, we consider there would not be a material increase in the probability of qualifying customers not receiving compensation, receiving the wrong compensation, or receiving compensation from the wrong CCS provider.
- 3.13 We estimate the aggregate cost for 36 CCS providers<sup>14</sup> to update their processes and procedures would be approximately \$30,000, broken down as follows:
  - (a) 5 larger CCS providers: \$2,000 each
  - (b) 9 medium-sized CCS providers: \$1,000 each
  - (c) 22 smaller CCS providers: \$500 each.<sup>15</sup>
- 3.14 A drawback of the proposal is that qualifying customers may be concerned a retailer they switch away from during a PCP would be unwilling to pay compensation. This perception may cause some consumers to not switch retailer until compensation has been paid. This would have a dampening effect on retail competition during, and soon after, a PCP. This outcome would be contrary to the proposal's objective.
- 3.15 We expect this outcome would be unlikely. We can address this potential customer concern by ensuring communications around a PCP inform qualifying customers who switch retailers of their right to compensation from each retailer they were supplied by during the PCP. We expect CCS providers will want to avoid this outcome in order to maintain a positive brand, which is important in a competitive environment. We also note that qualifying customers switching retailers may have other important motivations for switching, such as price.
- 3.16 Lastly, we note the proposal may slightly increase the risk of a qualifying customer not receiving compensation if they are a customer of a defaulting CCS provider. Under the provisions of Schedule 11.5 of the Code, a qualifying customer that moved from a defaulting CCS provider may not be compensated by their new retailer for the period of time they were supplied by the defaulting CCS provider. This could be either because the new retailer refused to accept the obligation or because the new retailer was not a CCS provider.
- 3.17 However, we note the qualifying customer has the choice of not entering into a contract with another retailer, and instead waiting for the Authority to assign the defaulting CCS provider's rights and responsibilities to another CCS provider.<sup>16</sup> This would mean the qualifying customer would receive compensation.

**We consider the proposal would have a net benefit**

- 3.18 Having assessed its benefits and costs, we believe the proposal is likely to offer a net benefit over the status quo.

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<sup>14</sup> Based on 36 traders recorded in the registry as at 31 December 2017 (refer to the market share breakdown available on the Authority's EMI website at [https://www.emi.ea.govt.nz/Retail/Reports/HR5D1V?\\_si=v|3,p|7](https://www.emi.ea.govt.nz/Retail/Reports/HR5D1V?_si=v|3,p|7)).

<sup>15</sup> Based on CCS providers each incurring an hourly labour cost of \$50 to update their processes and procedures.

<sup>16</sup> Refer to clause 4 of Schedule 11.5. The clause refers to 'trader' rather than CCS provider, but they mean the same thing for the purposes of this paper.

- 3.19 However, we note this net benefit may rely on CCS providers not having to make significant changes to their IT systems in order to give effect to the proposal—provided the cost of any such changes was economically efficient.<sup>17</sup> If CCS providers identify system change costs that are required only because of the proposal, and demonstrate these costs are economically efficient, then we will revise the cost-benefit analysis accordingly.

**Q5. Do you agree the proposal would not require system changes that had a higher economically-efficient cost to those system changes required to implement the current CCS arrangements? If you disagree, please provide details of your additional economically-efficient costs under the proposal.**

**Q6. Do you agree the benefits of the proposed amendment outweigh its costs?**

### **Our conclusion differs to the Electricity Commission's because underlying factors have changed**

- 3.20 In its September 2010 consultation paper on the design of the CCS arrangements, the Electricity Commission assessed the same proposal we are now considering against the option of assessing a CCS provider's payment obligation using a single date. The Electricity Commission concluded that:<sup>18</sup>
- (a) the proposal would raise several transactional complexities for retailers
  - (b) the proposal could introduce a level of confusion for customers, especially in the likely situation where different CCSs were in effect across retailers
  - (c) under the option of assessing a CCS provider's payment obligation using a single date, there would be small levels of payment-obligation gain and loss between CCS providers if their net customer gains differed from their losses during a PCP.
- 3.21 The Electricity Commission preferred, on balance, the transactional simplicity of the option now included in the Code.
- 3.22 We note the Electricity Commission's assessment was based on retailers developing their own customised CCSs. The proposed design of the CCS arrangements at that time allowed retailers to substitute a customised CCS for the default CCS, if they obtained Authority approval.<sup>19</sup> The Electricity Commission expected many retailers would develop and implement their own customised CCS rather than using the default CCS.
- 3.23 After the Electricity Commission undertook its assessment, and following further consultation with interested parties, the Authority amended the design of the CCS arrangements:
- (a) to require CCS providers to offer a default CCS that met the requirements of the default CCS set out in clause 9.24 of the Code

<sup>17</sup> In other words, the productive efficiency test held. Productive efficiency is achieved when products and services that consumers desire are produced at minimum cost to the economy. That is, the costs of production equal the minimum amount necessary to produce the output. A productive efficiency loss results if the costs of production are higher than this, because the additional resources used could instead be deployed productively elsewhere in the economy.

<sup>18</sup> Electricity Commission, 7 September 2010, Consultation paper: Customer Compensation Schemes, pp. 41-42, available at <http://www.ea.govt.nz/dmsdocument/8138>.

<sup>19</sup> Although the Authority had not been established at the time, its establishment was imminent. Hence, the Electricity Commission prepared a draft Code amendment, for handover to the Authority.

- (b) to permit a CCS provider to offer additional (customised) CCSs (ie, as well as the default CCS, not a substitute for it).
- 3.24 Under the amended design, the Authority no longer approved a customised CCS. Instead, qualifying customers ‘approved’ a customised CCS by agreeing to move to it from the default CCS. The Authority amended the design in this way following consideration of the difficulties inherent in designing appropriate<sup>20</sup> assessment criteria for it to use in approving customised schemes.<sup>21</sup>
- 3.25 This design amendment appears to have lessened the incentive for CCS providers to implement their own schemes, with no details of additional schemes made publicly available since the Code amendment was made in 2011.<sup>22</sup> This, in turn, fundamentally changes some of the assumptions underpinning the Electricity Commission’s assessment.
- 3.26 We have concluded that CCS providers may not put in place many additional CCSs. Therefore, we consider the proposal would be unlikely to introduce the level of customer confusion the Electricity Commission envisaged.
- 3.27 As discussed above, we consider the proposal is also unlikely to raise any material transactional complexities for CCS providers. We believe CCS providers would most likely use the same methods to pay compensation to customers under the proposal as they would under the status quo (eg, crediting customers’ invoices). CCS providers should also be able to calculate the amount of compensation they owe their qualifying customers using the same information and systems they use for reconciliation and customer invoicing.

### **We have identified an alternative to the proposal**

- 3.28 We identified the following alternative to the proposal:
- the CCS provider compensates a qualifying customer for each day of a PCP, if the qualifying customer was a customer of the CCS provider on the first day of the PCP.*
- 3.29 The Electricity Commission also identified this alternative in its September 2010 consultation paper.

### **We have undertaken a qualitative assessment of the alternative’s benefits**

- 3.30 The primary benefit of the alternative, compared with the status quo, would be to promote competition in the supply of electricity to qualifying customers. It would do this by lessening (as opposed to removing) the incentive on a CCS provider to:
- (a) not gain customers during a PCP, to avoid paying compensation to them for the days during the PCP when they were not the CCS provider’s qualifying customer

<sup>20</sup> The Authority noted such assessment criteria ideally needed to be both appropriate and unambiguous in the short term, while delivering policy sustainability and relevance in the longer term.

<sup>21</sup> Electricity Authority, 14 December 2010, Consultation paper: Customer Compensation Scheme – Mandatory Default Arrangement, p. 8, available at <http://www.ea.govt.nz/dmsdocument/8952>.

<sup>22</sup> Clause 9.28 of the Code requires a retailer who has 1 or more additional customer compensation schemes to—

(a) publish a description of its additional customer compensation schemes on an Internet site maintained by or on behalf of the retailer; and

(b) on request from a customer, provide a written description of the additional customer compensation schemes.



- (b) lose customers during a PCP, to avoid paying them any compensation.
- 3.31 Under the status quo, these incentives exist from before, or on, the date the PCP is announced until the last day of the PCP. Under the alternative, these incentives would exist for a shorter time period—equal to the duration of the PCP.

**We have undertaken a partial quantitative assessment of the alternative's costs**

- 3.32 We believe a material cost of the alternative, compared with the status quo, would be the transaction costs a CCS provider would incur when paying its qualifying customers. Under the alternative there would be more time for a CCS provider to lose customers between when the CCS provider became liable to pay a qualifying customer and when final payment occurred.<sup>23</sup> As a result, the CCS provider might no longer have the correct contact details for the qualifying customer, requiring the CCS provider to incur additional costs locating the customer and confirming payment arrangements.
- 3.33 Under the alternative there would also be the cost for CCS providers to update their processes and procedures. We estimate this cost to be the same as for the proposal. That is, the aggregate cost for 36 CCS providers<sup>24</sup> to update their processes and procedures would be approximately \$30,000, broken down as follows:
- (a) 5 larger CCS providers: \$2,000 each
  - (b) 9 medium-sized CCS providers: \$1,000 each
  - (c) 22 smaller CCS providers: \$500 each.<sup>25</sup>
- 3.34 As with the proposal, we do not believe CCS providers would need to make system changes under the alternative. However, the reason is different. As with the status quo, the alternative assigns liability to a CCS provider to pay qualifying customers based on a single date. Hence, we see no reason why CCS providers would need to change their systems under the alternative in a manner that differed from the status quo.
- 3.35 Compared with the status quo, we believe the alternative would also impose costs on CCS providers, and possibly qualifying customers, by creating greater uncertainty for CCS providers over their financial liability. On the first day of a PCP, a CCS provider would have no certainty as to how long the PCP was going to last, meaning the CCS provider's compensation liability would be unknown. This might place an additional incentive on the CCS provider to lose qualifying customers in advance of a possible PCP, even though this might later prove to be the wrong decision for the CCS provider.

**We consider the proposal offers a greater expected net benefit than the alternative**

- 3.36 We consider the proposal offers a greater expected net benefit than the alternative, because the proposal would better promote competition. The proposal removes the competition-dampening incentives under the status quo, whereas the alternative only lessens these incentives.

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<sup>23</sup> Assuming the CCS provider adopted the same payment timeframe under the alternative as it did under the status quo.

<sup>24</sup> Based on 36 traders recorded in the registry as at 31 December 2017 (refer to the market share breakdown available on the Authority's EMI website at [https://www.emi.ea.govt.nz/Retail/Reports/HR5D1V?\\_si=v|3,p|7](https://www.emi.ea.govt.nz/Retail/Reports/HR5D1V?_si=v|3,p|7)).

<sup>25</sup> Based on CCS providers each incurring an hourly labour cost of \$50 to update their processes and procedures.



- 3.37 We note our conclusion may rely on CCS providers not having to make changes to their IT systems in order to give effect to the proposal that were additional in cost to those system changes needed to implement the current CCS arrangements.

**Q7. Do you agree the proposed amendment is preferable to the status quo and the alternative? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory objective in section 15 of the Electricity Industry Act 2010.**

**Q8. Do you agree the benefits of the proposed amendment outweigh its costs?**

### **The proposed amendment complies with section 32(1) of the Act**

- 3.38 The Authority's objective under the Act is to promote competition in, reliable supply by, and efficient operation of, the electricity industry for the long-term benefit of consumers.
- 3.39 The Act says the Code may contain any provisions that are consistent with the Authority's objective and are necessary or desirable to promote one or all of the matters set out in Table 1.<sup>26</sup>
- 3.40 The proposal's expected net benefit means the proposal complies with the competition and efficiency limbs of the Authority's objective and is for the long-term benefit of consumers. Therefore, the proposal complies with section 32(1) of the Act.

**Table 1: Proposal's compliance with section 32(1) of the Act**

(a) competition in the electricity industry;	<p>The proposal is expected to have a positive effect on retail competition.</p> <p>The proposal can be viewed as creating a more 'level playing field' in the retail market, by requiring CCS providers to compensate qualifying customers only for the time they supply the qualifying customer.</p>
(b) the reliable supply of electricity to consumers;	<p>The proposal is expected to have a negligible effect on the reliable supply of electricity to consumers.</p> <p>While the proposal would mean individual CCS providers faced a different incentive in relation to reliable supply, on balance we believe the incentive across CCS providers <u>in aggregate</u> would be largely unchanged.</p>
(c) the efficient operation of the electricity industry;	<p>The proposal is expected to have a positive effect on the efficient operation of the electricity industry, although this benefit is not expected to be as material as the competition benefit.</p> <p>The proposal would remove a source of distortion in CCS providers' decision making and the potential for consumers to receive compensation for days during a PCP when they were purchasing electricity at a price based on the spot price.</p>
(d) the performance by the Authority of its	<p>The proposal would not materially affect the performance of the Authority's functions.</p>

<sup>26</sup> Refer to section 32(1) of the Act.

functions;	
(e) any other matter specifically referred to in this Act as a matter for inclusion in the Code.	The proposal would not materially affect any other matter specifically referred to in the Act for inclusion in the Code.

**Q9. Do you agree that the Authority's proposal complies with section 32(1) of the Electricity Industry Act 2010?**

**The Authority has given regard to the Code amendment principles**

- 3.41 When considering an amendment to the Code, the Authority must have regard to the Code amendment principles in its consultation charter, to the extent that it considers them applicable.<sup>27</sup> Table 2 describes the Authority's regard for the Code amendment principles during its consideration of the proposal.

**Table 2: Regard for Code amendment principles**

Principle	Comment
1. Lawful	The proposal is lawful and consistent with the empowering provisions of the Act. The proposal is consistent with the Authority's objective because it is for the long-term benefit of consumers.
2. Provides clearly identified efficiency gains or addresses market or regulatory failure	The evaluation of the proposal's benefits and costs in section 3 sets out the proposal's efficiency gains. We consider the proposal would deliver a net efficiency gain over the status quo.
3. Net benefits are quantified	Our evaluation of the proposal's benefits and costs in section 3 sets out the extent to which we have been able to quantify the proposal's net benefit. We consider the proposal's qualitative benefits would outweigh its qualitative and quantitative costs.

**Q10. Do you agree with the Authority's assessment of the proposal against the Code amendment principles? Please give reasons if you do not.**

<sup>27</sup>

The consultation charter is one of our foundation documents and is available at: <http://www.ea.govt.nz/about-us/documents-publications/foundation-documents/>.

## Appendix A Proposed Code amendment

A.1 The proposed Code amendment is set out below.

### Proposed amendments to Part 9

#### Subpart 4—Customer compensation schemes

##### 9.21 Qualifying customers

- (1) A **retailer's qualifying customer** is a person who, as at any time during the end of the last day of a public conservation period, —
  - (a) is a **customer** of the **retailer**; and
  - (b) has a contract with the **retailer** for the supply of **electricity** in respect of an **ICP** at which—
    - (i) there is a **category 1 metering installation** or a **category 2 metering installation**; and
    - (ii) there was consumption, in the 12 months immediately before the start of the **public conservation period**, of 3000 kWh or more.
- (2) Despite subclause (1), a person is not a **qualifying customer** if the price of all of the **electricity** provided under the person's contract with the **retailer** for the supply of **electricity** is determined by reference to the **final price** at a **GXP**.
- (3) For the purposes of subclause (1)(b)(ii), if a **qualifying customer's** consumption at the **ICP** in the 12 months immediately before the start of the **public conservation period** is not available to the **retailer**, the **retailer** must make a reasonable estimate of the consumption.
- (4) To avoid doubt,—
  - (a) ~~the retailer is not required to make payments to a~~ **qualifying customer** at an **ICP** in respect of any period during, at the end of the last day of a public conservation period, when—
    - (i) the premises to which the **ICP** is **electrically connected** are vacant; or
    - (ii) the **ICP** is **electrically disconnected**;
  - (b) ~~a retailer's qualifying customers includes a customer who switched—~~
    - (i) ~~to the retailer from another retailer on or before the last day of a public conservation period, including during that public conservation period; or~~
    - (ii) ~~from the retailer to another retailer between the last day of a public conservation period and the date on which the retailer pays compensation under the customer compensation scheme.~~

...

#### *Default customer compensation scheme*

##### 9.24 Requirements of default customer compensation schemes

- (1) A **retailer's default customer compensation scheme** must provide for the **retailer**—
  - (a) during an **official conservation campaign** for the South Island, to pay each of its **qualifying customers** in the South Island at least the minimum weekly amount of compensation, determined by the **Authority** under clause 9.25, at a pro rata daily rate, for each day each week of the official conservation campaign that the qualifying customer is the retailer's customer; and

- (b) at any other time during a **public conservation period**, to pay each of its **qualifying customers** at least the minimum weekly amount of compensation, determined by the **Authority** under clause 9.25, at a pro rata daily rate, for each day each week of the public conservation period that the qualifying customer is the retailer's customer; and
  - (c) to pay at least the minimum weekly amount, at a pro rata daily rate, for each day of a public conservation period that the qualifying customer is the retailer's customer—
    - (i) to each of its **qualifying customers** in the South Island or New Zealand (as the case may be), for each of the **qualifying customer's ICPs** described in clause 9.21(1)(b);
    - (ii) no later than the end of 2 **billing periods** after the last day of a **public conservation period**.
- ~~(2) Each **retailer's default customer compensation scheme** must provide that if a **public conservation period** runs for more than a whole number of weeks, the **retailer** must, in addition to making payments in accordance with subclause (1) for each whole week of the **public conservation period**, pay at least the minimum weekly amount of compensation at a pro rata daily rate for the number of days that exceed the whole number of weeks of the **public conservation period**.~~
- (3) For the purposes of this clause—
- (a) compensation includes—
    - (i) money;
    - (ii) a credit on the **qualifying customer's electricity** account with the **retailer**; and
  - (b) the form of the compensation is to be determined by the **retailer**.

**Q11. Do you have any comments on the drafting of the proposed amendment?**

## Appendix B Format for submissions

Submitter	
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Question	Comment
Q1. Do you agree there are adverse effects on retail competition and market efficiency from a retailer having to compensate a qualifying customer for all of a PCP regardless of whether the retailer supplies the qualifying customer for all of the PCP?	
Q2. Do you agree with our proposed approach to addressing these adverse effects?	
Q3. Do you agree the current requirement for the Authority to review the MWA <u>at least</u> once every three years is appropriate?	
Q4. Do you agree with the proposal's objective? If not, why not?	
Q5. Do you agree the proposal would not require system changes that had a higher economically-efficient cost to those system changes required to implement the current CCS arrangements? If you disagree, please provide details of your additional economically-efficient costs under the proposal.	
Q6. Do you agree the benefits of the proposed amendment outweigh its costs?	
Q7. Do you agree the proposed amendment is preferable to the status quo and the alternative? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory objective in section 15 of the Electricity Industry Act 2010.	
Q8. Do you agree the benefits of the proposed amendment outweigh its costs?	
Q9. Do you agree that the Authority's proposal complies with section 32(1) of the Electricity Industry Act 2010?	
Q10. Do you agree with the Authority's assessment of the proposal against the Code amendment principles? Please give reasons if you do not.	
Q11. Do you have any comments on the drafting of the proposed amendment?	

## Glossary of abbreviations and terms

<b>Act</b>	Electricity Industry Act 2010
<b>Authority</b>	Electricity Authority
<b>CCS</b>	Customer compensation scheme
<b>Code</b>	Electricity Industry Participation Code 2010
<b>FPVV</b>	Fixed price variable volume
<b>GXP</b>	Grid exit point
<b>ICP</b>	Installation control point
<b>OCC</b>	Official conservation campaign
<b>PCP</b>	Public conservation period