

# Review of two aspects of the customer compensation scheme

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## Summary of submissions

29 May 2018



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# 1 Purpose of this paper

- 1.1 This paper provides a summary of the submissions received by the Electricity Authority (Authority) on the consultation paper *Review of two aspects of the customer compensation scheme*, which we published on 20 February 2018.<sup>1</sup>
- 1.2 In the consultation paper we sought submissions on the following two matters:
- (a) Our proposal to amend the Electricity Industry Participation Code 2010 (Code) to require those retailers that must pay compensation during a public conservation period (PCP) to compensate a qualifying customer only for the days during a PCP that the retailer supplies the qualifying customer.
  - (b) Our conclusion that there was insufficient justification for amending the Code to put in place a different timeframe for reviewing the minimum weekly amount (MWA) paid to qualifying customers when there is a PCP.

## Submissions received

- 1.3 We received six submissions on the consultation paper, from the parties listed in Table 1. The submissions are on our website at: [www.ea.govt.nz/development/work-programme/risk-management/review-of-the-customer-compensation-scheme-ccs/consultation/#c16987](http://www.ea.govt.nz/development/work-programme/risk-management/review-of-the-customer-compensation-scheme-ccs/consultation/#c16987).

**Table 1: List of submitters**

Submitter	Category
Contact Energy Limited	Electricity generator and retailer
Flick Energy Limited	Electricity retailer
Mercury NZ Limited	Electricity generator and retailer
Meridian Energy Limited	Electricity generator and retailer
Nova Energy Limited	Electricity generator and retailer
The Alliance of Independent Retailers (TAIR) joint submission representing:  Ecotricity Limited Electric Kiwi Limited Pioneer Energy Limited Pulse Energy Alliance LLP Simply Group Limited Vocus Group	  Electricity retailer Electricity retailer Electricity (embedded) generator and retailer Electricity retailer Electricity retailer Electricity retailer

<sup>1</sup> Electricity Authority, 20 February 2018, *Review of two aspects of the customer compensation scheme*, available at [www.ea.govt.nz/dmsdocument/23045](http://www.ea.govt.nz/dmsdocument/23045).

## 2 Summary of submissions

2.1 Table 2 summarises the responses we received to the questions asked in our 20 February 2018 consultation paper.

**Table 2: Summary of responses to questions**

Question 1	<b>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?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	<p>Yes. Flick is supportive to the Authority addressing this.</p> <p>Flick reiterates the comments made in our earlier submission on this matter and would encourage the Authority to continue to support the development of hedge markets. Especially for the benefit of parties who are not gentailers and who are therefore not able to balance their generation and retail exposure.</p> <p>Again, in terms of security of supply Flick would encourage the Authority to focus on continuing to improve the performance of the market.</p>
Mercury NZ Limited	No response provided.
Meridian Energy Limited	<p>Yes. We agree that the current arrangements have the potential to significantly distort retail competition because some retailers might be:</p> <ul style="list-style-type: none"> <li>• reluctant to take on customers during the campaign;</li> <li>• more likely to let customers go; or</li> <li>• have an incentive to push customers away or recover additional costs through price rises (assuming the campaign lasts more than the 30 day notice required for a price increase).</li> </ul> <p>Non-eligible (spot exposed) customers might also have a greater incentive under the status quo to switch to a different plan or provider in the final days of a campaign, receive a compensation payment, and then switch back.</p>
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.

<b>Question 2</b>	<b>Do you agree with our proposed approach to addressing these adverse effects?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	Yes.
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.
<b>Question 3</b>	<b>Do you agree the current requirement for the Authority to review the MWA at least once every three years is appropriate?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	New forms of retail pricing and demand response schemes will continue to come to market so perhaps this is too long given the levels of change in the electricity retail market.
Mercury NZ Limited	We also agree that amending the Code to put in place a different timeframe for reviewing the minimum weekly amount (MWA) paid to qualifying customers is not justified as there is sufficient flexibility available now to accommodate any necessary changes.
Meridian Energy Limited	Yes. Meridian supports the Authority's conclusion that amending the Code to put in place a different timeframe for reviewing the minimum weekly amount is not justified. The Authority can always review the amount more frequently if necessary following a change in the key inputs.
Nova Energy Limited	Nova also agrees with matter two, reviewing the CCS at least once every three years.
The Alliance of Independent Retailers (TAIR) joint submission	<p>The MWA amount of \$10.50 per week of a public conservation campaign (PCP) is unchanged since it was first introduced in 2010 and yet it is supposed to be "approximately cost-neutral to CCS providers".</p> <p>This intuitively does not sound right.</p> <p>Assuming a consumer makes no change to its consumption during a PCP – adding the \$10.50 per week compensation obligation has</p>

	<p>dire consequences for new entrant retailers who have a naturally short position (this is before thinking about what the spot price might be for purchasing electricity).</p> <p>The \$10.50 per week payment exceeds the gross margin for the vast majority of customers, let alone the overheads of running the business for a short retailer in start-up mode.</p> <p>Further, the risk of having to pay customer compensation is not insurable or hedgeable. It is impossible to manage the risk of having to pay this compensation – a short retailer can not purchase insurance to cover this risk, or a hedge contract. This contrasts with the vertically integrated long gentailer who will continue to manage its risk by managing its retail portfolio to match its expected generation (hydro gentailers) or managing its generation to match its retail portfolio (thermal gentailers). Therefore the risks of this scheme are asymmetric. This risk falls disproportionately on new entrant retailers that do not own generation and who have neither direct control over the plant they contract with via derivatives, nor the embedded real option associated with generation plant ownership.</p> <p>The CCS payment obligation is a contingent obligation. That is, it is contingent on a sequence of events. The sequence of events is specified within the Code. The consequence of the events occurring is also specified within the Code (the CCS payment). The EA as required by the Code has specified how the CCS payment is determined. The CCS is not a natural consequence/risk of the market, it has been added to the market risk profile in a deterministic manner. While the contingent liability may seem insurable through traditional means, Pulse's enquiries suggest this is not the case.</p> <p>In addition, the Authority is assuming that retailers will spend additional money to improve the (uncertain) savings rate and this cost does not appear to be factored in.</p> <p>The Authority states that a fully hedge retailer can retain some unknown fraction of an uncertain pay-off if it is fully hedged, but ignores both the cost of being fully hedged (an unspecified definition) and that fully or perfect hedging is impossible. It is likely that the net pay off to a reasonably hedged retailer will still be negative relative to the fixed prices it has sold on.</p> <p>The Authority's own logic also implies that unhedged retailers effectively reduce security of supply and therefore increase the probability of an OCC occurring. By inference retailers selling spot are therefore reducing security of supply but are excluded from the CCS and therefore are free riding.</p> <p>Overall, the only conclusion that can be drawn is that the Authority's statements that the MWA is cost neutral can not be correct, or is correct only under a limited set of assumptions, or is correct only in some probabilistic sense, or is correct only because the Authority is ignoring some very real costs.</p> <p>We request the Authority publish the maths to show that the MWA is cost neutral. This is essential before any decision is made about the length of time before the next review of the MWA.</p>
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<b>Question 4</b>	<b>Do you agree with the proposal's objective? If not, why not?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	Yes.
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.
<b>Question 5</b>	<b>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.</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	As a spot market retailer Flick is not in a position to comment on the system change requirements.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	<p>The proposal will require changes to Meridian systems and processes.</p> <p>In addition to the cost of system changes, the proposal would also increase the cost of administering payments in the event of an official conservation campaign. In particular, there would be a high cost to administer payments for customers that leave during a conservation period. Tracking down and arranging to pay former customers by cheque or bank transfer would cost more than a simple bill credit applied to an existing customer's account (as would likely occur under the status quo).</p> <p>A potential solution to this problem will be for retailers to develop the capability to calculate the necessary compensation payments in time for them to be applied to the final bill of a departing customer. In many cases the compensation payment will offset the final amount owing on an account – this is far simpler administratively than providing customers with a check or payment to a nominated</p>

	<p>bank account.</p> <p>Developing the capability to process compensation payments in time for final billing would be more costly than the Authority's current estimate of process change costs, which seems based on a simple process where compensation can be paid up to two billing periods after the end of a conservation period.</p> <p>While it is important the Authority takes these additional costs into account, we believe that on balance the proposal would have net benefits.</p>
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.
<b>Question 6</b>	<b>Do you agree the benefits of the proposed amendment outweigh its costs?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	<p>Yes. While we support the proposal, we do not think that the Authority has identified the full range of costs associated with it. In addition to the one-off costs of retail process changes, the cost of administering compensation payments in the event of an official conservation campaign would also increase when compared with the status quo. In particular, there would be a high cost to administer payments for customers that leave during a conservation period. Calculating and arranging payments to customers as they switch away would be more costly than a simple bill credit applied to a current customer's account (as would occur under the status quo up to two billing periods following a campaign). While it is important that the Authority takes these costs into account we believe that on balance the proposal would still result in net benefits.</p>
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	<p>We question whether there is sufficient 'efficiency' implications from this to warrant a one-off cost to retailers to change in systems and processes etc. The consumer ultimately pays for the cost of implementing this Code amendment.</p> <p>If there is an efficient gain from making this change it is totally</p>



	insignificant in the context of the cost of the scheme to pure play retailers.
<b>Question 7</b>	<b>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.</b>
Contact Energy Limited	Contact supports the Authority's proposal to amend the Code to require a customer compensation scheme (CCS) provider to compensate a qualifying customer only for the days during a public conservation period that the CCS provider supplied the qualifying customer.
Flick Energy Limited	Yes.
Mercury NZ Limited	Mercury supports the proposed refinements to the CCS. We believe electricity retailers (or more accurately, CCS Providers as this term is defined in the Consultation paper) should only be required to compensate qualifying customers for the days they supplied qualifying customers during a public compensation campaign.
Meridian Energy Limited	Yes. Meridian supports the Authority's proposal to require retailers to compensate qualifying customers only for the days during a conservation campaign that the retailer supplies the qualifying customer.
Nova Energy Limited	Nova supports the change as it is consistent with the addressing the fault in the existing scheme that Nova highlighted in its submission on the CCS in 2016.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.
<b>Question 8</b>	<b>Do you agree the benefits of the proposed amendment outweigh its costs?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	Yes.
Nova Energy	The benefits of the proposed amendment clearly outweigh any

Limited	costs.
The Alliance of Independent Retailers (TAIR) joint submission	<p>We question whether there is sufficient 'efficiency' implications from this to warrant a one-off cost to retailers to change in systems and processes etc. The consumer ultimately pays for the cost of implementing this Code amendment.</p> <p>If there is an efficient gain from making this change it is totally insignificant in the context of the cost of the scheme to pure play retailers.</p>
<b>Question 9</b>	<b>Do you agree that the Authority's proposal complies with section 32(1) of the Electricity Industry Act 2010?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes. It is a good move in terms of competition and efficient operation.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	Yes.
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.
<b>Question 10</b>	<b>Do you agree with the Authority's assessment of the proposal against the Code amendment principles? Please give reasons if you do not.</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	Yes. The proposal appears to align with the Code Amendment principles.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	Yes.
Nova Energy Limited	No response provided.
The Alliance of	No response provided.

Independent Retailers (TAIR) joint submission	
<b>Question 11</b>	<b>Do you have any comments on the drafting of the proposed amendment?</b>
Contact Energy Limited	No response provided.
Flick Energy Limited	No.
Mercury NZ Limited	No response provided.
Meridian Energy Limited	No.
Nova Energy Limited	No response provided.
The Alliance of Independent Retailers (TAIR) joint submission	No response provided.

- 2.2 Some submitters raised matters that were not a direct response to one of the questions in the consultation paper. Table 3 summarises these other matters.

**Table 3: Other matters raised by submitters**

Submitter	Matter raised
Mercury NZ Limited	<p>Mercury is generally supportive of a CCS and believes that an appropriately designed scheme should provide an incentive to manage dry year risk to prevent an official conservation campaign (OCC). This in turn has the potential to drive additional demand for hedging and/or generation investment to limit the likelihood that an OCC is triggered.</p> <p>However, we would like to take this opportunity to suggest, that since the 2016/17 review of the CCS was completed, the electricity market has experienced another dry year and issues have been raised relating to both contingent storage and the hydro risk curves used by the System Operator to manage dry year risk.</p> <p>Mercury considers it would be useful to undertake a broader review of the CCS focusing on whether there is scope to better incentivise the management of physical storage for the market. We have recently raised concerns in our feedback to the System Operator on the Genesis proposal to review the hydro risk curve assumptions as they relate to fuel limitations, and also during the discussions about</p>

	managing dry year risk over Winter 2017. We would be happy to engage further on these topics.
Meridian Energy	<p>While the proposal will help to ease the potential burden of a trader default, Meridian considers that there potentially remain some issues with the customer compensation scheme in trader default situations. If voluntary customer switching and the tender process do not result in all of the defaulting trader's customers being allocated to a new trader, the Authority will assign the remaining customers to others in the same network areas based on their market share. In these mandatory allocation situations a trader may not want additional customers for commercial reasons (it seems they will have already passed up the chance to acquire the additional customers voluntarily) and there is an open question in our view as to whether it is really to the long term benefit of consumers for traders to be required to also make compensation payments to customers who have been assigned to them against their wishes. We suggest the Authority should carefully consider whether customers allocated in this mandatory fashion should be deemed qualifying customers for the purposes of the customer compensation scheme – it may be that treating them as such increases the risk of the same type of retail competition distortions that the Authority is seeking to avoid by the other amendments it proposes.</p>
The Alliance of Independent Retailers (TAIR) joint submission	<p>Our Alliance believes that the Customer Compensation Scheme overall is inconsistent with the Electricity Authority's (Authority) statutory objective to promote competition and ensure the efficient operation of the electricity market.</p> <p>The proposed amendment imposes additional costs on retailers, and therefore consumers. It represents a tweak to a scheme which we submit is an unnecessary ambulance at the bottom of the cliff.</p> <p>The scheme provides for payments to customers – not compensation – as no demand response is required and it is designed to penalise retailers irrespective of their contribution to the cause.</p>