

28 November 2019

Dr Brent Layton
Chair
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By e-mail: appropriations@ea.govt.nz

Dear Brent

2020/21 Levy-funded appropriations

Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus appreciate the opportunity to submit in relation to the 2020/21 Levy-funded appropriations consultation.

As a group, we collectively represent 8.64% of the electricity retail market, or 96.54% of the electricity retail market supplied by independent retailers.¹ We are proudly independent entrant retailers who are responsible for delivering New Zealanders choice, innovation and keeping prices down.

Summary of the independent retailers' views

- **We welcome the Authority's decision to undertake a strategic reset.** The Authority has noted it "has taken into account feedback that it should involve participants more in its decision-making processes" and "will engage stakeholders early and regularly".² We look forward to engaging with the Authority throughout the strategy development process over the next six months.
- **Government EPR reforms need to take priority over existing Authority projects including TPM:** We look forward to seeing as soon as possible after the 18 December Board meeting how the Authority is prioritising and reshaping the work programme to incorporate the Government's EPR decisions and expectations. We are concerned, though, by indications the Authority will be undertaking a substantial amount of work and consultation on the TPM and the TPM CBA over the next 6-months (potentially longer) and the TPM review will continue to be a distraction from more important priorities.
- **There should be a greater focus on eliminating barriers to competition** in the electricity retail and wholesale markets, and in ensuring a more level playing field. This will naturally be a strong immediate-term focus for the Authority as it implements the Government's Electricity Price Review (EPR) reforms, at least in relation to the retail market. We would like to see an ambitious focus on elimination of market concentration followed by progression towards a fully competitive market. A fully competitive wholesale market (spot and hedge) is essential for growth in retail competition.

¹ By contrast, ERANZ represents 100% of the incumbent retailers and one independent retailer supplying 1,336 ICPs (0.06%) of the retail market (data from ERNAZ' website on 19 November 2019).

² Electricity Authority, Hedge Market Enhancements (market making), Ensuring market making arrangements are fit-for-purpose over time, Discussion paper, November 2019.

- **Gap in the Authority’s market concentration statistics:** It is notable while the Authority uses electricity retail Herfindahl-Hirschman Index (HHI) and CR4³ statistics to measure whether it has achieved “Overall improvement across a suite of statistics on electricity market competition” it does not use the same measures for the wholesale market.
- **The Authority should focus on expedient and timely project delivery,** including the use of firmer KPIs and ‘stretch’ targets to drive operational excellence and ensure projects are completed in a timely manner. We reiterate from last year’s joint submission⁴ that we would like to see the Authority deliver on its intention to “[set] more ambitious targets for our top priority projects” and “deliver ... projects faster, so that the benefits for consumers are realised sooner”.⁵
- **The Authority must avoid being paralysed by inertia.** While it is prudent and appropriate for the Authority to consider the risks of getting its decisions wrong, the Authority should also have at front and centre of mind the risks of unintended consequences and outcomes from inaction and delay. We note the Authority’s preference for “options that can be implemented in easily reversible stages, or on a trial basis, and for which it is easy and low cost to step away from, with few long-term consequences for the market”.⁶
- **We support the extra funding the Authority is seeking for EPR implementation.** Our expectation is most of the work should be completed prior to by 30 June 2020, and all within 12 months of the government’s decisions at the latest. This is consistent with the timelines detailed in the EPR final report.⁷
- **We support “a short-term uplift in resourcing in 2020/21 to align organisational capability with our refreshed strategy”.**
- **There is an opportunity to re-prioritise some of the Authority’s existing budget** and resourcing levels e.g. putting the TPM review on hold. While we recognise most of the TPM review is a ‘sunk cost’, we can’t help think ‘what if’ and ‘if only’ about the outcomes that could have been delivered for consumers if the same time and resource had instead been dedicated to addressing wholesale and retail market competition issues over the last decade.

There is a risk of unintended consequences from inertia

From our observation, the Authority appears to only raise the risk of unintended consequences for potential reforms it does not favour e.g. the Authority has made the comment repeatedly in relation to hedge market reform, but as far as we are aware has never raised it in relation to its TPM proposals despite the radical and untested nature of those proposals.

There is also risk of unintended consequences and outcomes from inertia and not responding to changing market circumstances quickly enough. In balancing the need to get reform design right and timely response to market and regulatory problems, it is important to be mindful of Voltaire’s

³ CR4 denotes the combined market shares (concentration ratio) of the four largest firms.

⁴ Electric Kiwi, Flick Electric, Pulse Energy and Vocus, Joint submission from independent retailers – indicative work programme for 2019/20, 6 December 2018.

⁵ <https://www.ea.govt.nz/dmsdocument/23836-market-brief-24-july-2018#mctoc1>

⁶ Electricity Authority, Hedge Market Enhancements (market making) discussion paper November 2019, pages 24-25.

⁷ Based on the Hedge Market Enhancements discussion paper it appears that development of new hedge market arrangements will spill over into 2020/21 with no surety that final decisions won’t bear made until 2021.

warning “Perfect is the enemy of good” or more literally “the best is the enemy of the good”. The Minister of Energy and Resources expressed similar sentiment in commenting, in relation to hedge market reform, that “I want to be assured the fragility previously observed in the wholesale market at times of stress is not repeated in future, and I will make it clear I do not want to wait for a “better solution” that might never be found”.⁸

It was evident from the Post Implementation Review in 2017 that the opt-in Saves Protection Scheme was ineffectual and that it would have been better if the Authority had adopted a complete ban on saves and winbacks. The subsequent delay in replacing the scheme with a full ban on saves and winbacks has become an increasingly larger detriment to consumers. It has been well documented that the two-tier retail market/saves and winbacks problem has substantially worsened.

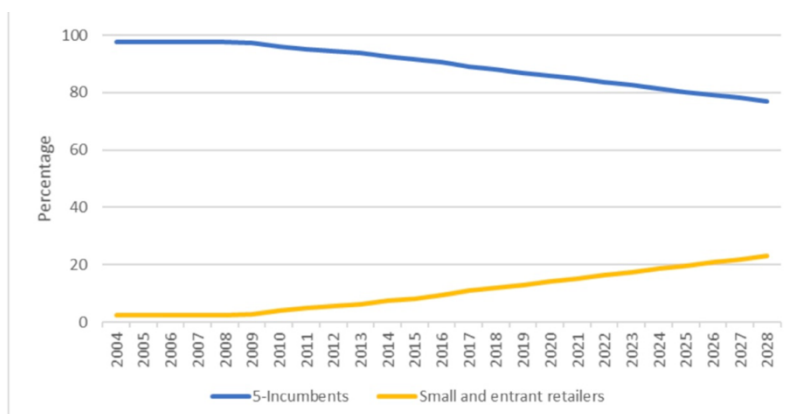
We would like to see a near-term focus on rapid elimination of market concentration

We wholeheartedly welcome the Authority’s desire to “[set] a foundation so all retailers – large and small, old and new – have equal opportunity to compete for customers” and to “[put] ... pressure on retailers to fight for their customers and offer them something new and different”.⁹

While competitive market metrics are improving, at least in relation to the retail market, the rate of change and progress has been far slower than it should.

Market trends since the inception of the Authority show independent retailers being able to grow at only about 1% per annum in aggregate. If this trend continues then the next decade will continue to be blighted by a strongly oligopolistic retailer market, with the incumbent retailers retaining over 80% of the entire electricity retail market in 2030. This is reflected in the following diagram which extrapolates market share changes based on the trend since the Authority was established.¹⁰

Figure 1: Changes in electricity retail market share



The Vocus submission to the EPR warned that “we would not like to see ... need for another review in another nine- or ten-years’ time, because the market is still oligopolistic and the five largest incumbent retailers market share has only decreased to 80%. This is where the sector is heading if the Price Review fails to improve competition”.¹¹ We agree. Precisely the same message should be at

⁸ Hon Dr Megan Woods, Minister of Energy and Resources, Cabinet Paper, Electricity Price Review: Government Response to Final Report, 3 October 2019.

⁹ <https://www.ea.govt.nz/about-us/media-and-publications/media-releases/2019/electricity-authority-welcomes-electricity-price-review-report-2/>

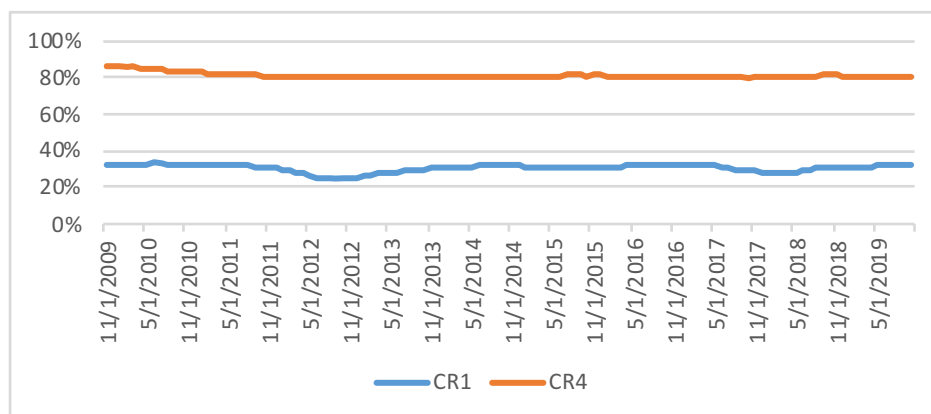
¹⁰ Vocus, Submission on Electricity Price Review first report, 19 October 2018.

¹¹ Vocus, Submission on Electricity Price Review first report, 19 October 2018.

the forefront of the Authority’s mind, particularly with the indication that the Government will undertake a review of the implementation and effectiveness of the EPR reforms.

The trend in wholesale electricity market share is worse than for retail, with the market share of the largest 4 generators basically unchanged since the Authority was established.

Figure 2: Changes in wholesale electricity market share (unweighted 12-month rolling average)



If the Authority wants to be ambitious for Kiwi consumers, and be seen as a world-leading regulator, it shouldn’t settle for either the gradual improvements in a selection of retail competition measures or the lack of change in the wholesale market. It should be driving targets to speed up the complete removal of market concentration and increasing the rate at which competition measures are improving.

Questions about the Authority’s hedge market development performance and KPIs

We have been struggling to reconcile the Authority’s views on its performance on progress with hedge market development with our observation that market conditions and liquidity have deteriorated while the work programme has not progressed over the last several years.

The Authority’s assessment of its hedge market development KPIs for 2017/18 was “Target not achieved”. We agree and would make similar comments for subsequent years.¹²

Programme D: Risk and risk management

This programme covers initiatives to promote efficient management of capacity and energy risks. This programme aligns with our *increase flexibility and resilience* strategy.

Project No.	Project	Priority	Description	Why we are doing this project	2017/18 target	Status	Comment
D1	Introduction of hedge market cap products	1	Introduction of exchange traded cap products to provide more transparent pricing of supply risks and encourage the provision of infrequently dispatched generation plant. Aiming to have both energy (lower strike price) and capacity (higher strike price) products listed. Ensuring the Electricity Contracts webpage is able to record cap transactions.	We seek to improve retail competition and security of supply by giving market participants greater certainty about forward price expectations.	Listing of exchange traded cap products. Monitor and report on trading performance once caps are listed.		Target not achieved. ASX has indicated their intention to list NZ cap futures products but did not achieve the project timeline. The Authority is in discussion with the ASX about a listing date. We are continuing to develop an EMI based monitoring report, planned to be published after ASX caps are listed.

¹² <https://www.ea.govt.nz/dmsdocument/23899-report-against-the-201718-work-programme-1-july-2017-30-june-2018>

While the Authority did “not achieve” its 2017/18 target, it removed any KPI or target for 2018/19.¹³

The 2018/19 Annual Report, nevertheless, reported the Authority was “On track” in relation to the hedge market. This wasn’t on the basis of progressing hedge market development and reform, which was not part of the Authority’s work programme in 2018/19, but rather on the basis of narrow, selective, hedge market participation measures. Over the same time period, the Authority has also noted “Stakeholders have expressed concerns to the Authority about the efficiency of prices and the ease with which deals can be struck during these periods, particularly since the Pohokura gas field outage in spring 2018”.¹⁴

IMPACT MEASURES	STATUS	RESULT
a. Improved information availability, for example, on the Electricity Authority’s website and EMI.	○ ○ ●	On track. Information availability is improving, as indicated by increases in visitors to, and data volumes downloaded from, the Authority and Electricity Market Information (EMI) websites.*
b. More and varied participants providing new services to consumers, for example, new retailers entering the market, and new products being offered.	○ ○ ●	On track. New retailers are entering the market and providing new services to consumers, as indicated by the change in the number of retail parent companies.**
c. Improved risk management, for example, increased hedge market participation.	○ ○ ●	On track. Key measures of hedge market participation improved in 2018/19, as indicated by traded volumes and open interest for ETIs.*** This was despite difficult trading conditions brought about by gas outages and low hydro storage in spring 2018. Other measures demonstrated the hedge market was under some stress during the period of supply shortage, such as the widening of bid asks spreads for ETIs.

It is unclear whether the Authority considers the recent release of the hedge market consultation means it is “On target” to meet the KPI for 2019/20 to “Decide design of enduring market making”.¹⁵ The Authority has only indicated “the Board of the Authority intends to make a high-level decision on enduring market making arrangements in May 2020” [emphasis added] which suggests it is unlikely new hedge market arrangements will be designed and implemented this financial year.¹⁶

Project name	Description	Why we are doing this project	Link to programme	Project lifecycle, and targets	
				Indicative Project completion	2019/20 target descriptions
Resuming					
Hedge market enhancements	A project to progress the hedge market recommendation resulting from the Authority’s review of winter 2017: <ul style="list-style-type: none"> investigate and make on-going enhancements to the hedge market investigate the value of further development of exchange traded (ASX) products Evaluation of incentive based arrangements for market making Review of the hedge disclosure website.	To provide more transparent and robust forward price signals, and an electricity market that is more competitive, being readily accessible for existing participants and purchasers, as well as for new entrant generators and retailers. This project is in response to the results of the investigation around potential UTS.	C – Pricing and cost allocation	Q3 20/21	Decide design of enduring market making

¹³ <https://www.ea.govt.nz/dmsdocument/23834-201819-work-programme>

¹⁴ https://www.ea.govt.nz/about-us/media-and-publications/media-releases/2019/electricity-authority-seeks-more-information-on-the-futures-market-and-market-making-arrangements/?utm_source=Electricity+Authority+Subscribers&utm_campaign=c951cdb76-Market+Brief+-+12+November+2019&utm_medium=email&utm_term=0_9103cdb36a-c951cdb76-711989121

¹⁵ <https://www.ea.govt.nz/dmsdocument/25479-201920-work-programme>

¹⁶ Electricity Authority, Hedge Market Enhancements (market making), Ensuring market making arrangements are fit-for-purpose over time, Discussion paper, November 2019.

We are concerned the current Appropriations consultation paper indicates the investigation into hedge market enhancements won't be completed until March 2021. There is no mention of Code amendments or implementation in this work programme.

Hedge Market enhancements	Progress the hedge market recommendation resulting from the Authority's view of winter 2017:	Q3 2020/21
	<ul style="list-style-type: none">• Investigate and make on-going enhancements to the hedge market• Investigate the value of further development of exchange traded (ASX) products• Evaluation of incentive based arrangements for market making• Review of the hedge disclosure website	

Stakeholder and Electricity Authority performance expectations could be better aligned

The Authority naturally faces a range of competing interests and views which it needs to weigh up to determine what is in the long-term benefit of consumers. Our views are well aligned with that of consumers, and the Authority's statutory objective, as successful promotion of competition for the long-term benefit of consumers will generally benefit both consumers and independent and new entrant retailers. It is no exaggeration that our very existence hinges entirely on development of a competitive market – both wholesale and retail markets.

If we look back at our last appropriations submission it isn't apparent any of our key concerns or recommendations have been addressed:¹⁷

Summary of our concerns and key recommendations

- We are concerned the indicative work programme won't help the Electricity Authority meet its commitment to deliver projects faster and set "more ambitious targets for our top priority projects, with associated changes to budget and resource allocations per project".³
- The proposed KPIs allow projects to continue to take too long to progress and complete.
- It should not have taken 7-years to produce the last two consultation papers on distribution pricing. This is far too long. The Electricity Authority is expecting electricity distributors to move faster on distribution pricing than it has been capable of itself, and is yet to confirm the pricing principles which should be applied.
- We **recommend** the Electricity Authority set, and then ensure compliance with, a fixed deadline for distribution pricing reform.
- Each of the proposed KPIs for the two-tier retail market (saves and winbacks), hedge market development, and spot market trading conduct projects should be met within the current financial year, not by the end of 2019/20. We would welcome consultation on the hedge market and spot market trading early (first quarter) in 2019.
- We **recommend** the Electricity Authority fast-track the two-tier retail market (saves and winbacks), hedge market development, and spot market trading conduct projects.
- We **recommend** the Electricity Authority expand the KPIs for each of its projects to include major project milestones, such as each consultation step, and target completion dates.

Recap of the previous independent retailer submission

Unfortunately, the lack of progress on important competition issues means we could essentially re-submit last year's joint submission. It is still relevant that:

- "The Commerce Commission implementation of the new fibre regulatory framework provides useful benchmark" against which the Authority can compare its own project management and delivery.

¹⁷ Electric Kiwi, Flick Electric, Pulse Energy and Vocus, Joint submission from independent retailers – indicative work programme for 2019/20, 6 December 2018.

- “The lack of progress on the spot market trading conduct highlights the problems with project inertia”. A year on we are still waiting for a consultation paper to be released (now expected to be released in “early 2020”¹⁸ with conclusion of this project by June 2021¹⁹ when the review was triggered by an event in 2017). We remain more hopeful that Genesis’ apparent breach of the High Standard of Trading Conduct rules will provide useful precedent for what is and is not acceptable conduct.
- “We want the Electricity Authority to “deliver ... projects faster, so that the benefits for consumers are realised sooner”. We are still waiting to see sign of the Authority delivering on its stated intention of “setting more ambitious targets for our top priority projects”.²⁰
- “Submissions to the Electricity Price Review send a clear message retail competition issues need to be addressed as a priority”. This has been confirmed by the subsequent EPR final report and the Government’s EPR electricity reform decisions.
- “Submissions to the Electricity Price Review bolster support for our concerns about the two-tier retail market (saves and winbacks)”. While the Authority has been silent on its views about submissions to the EPR we welcome that its views about the problem align with stakeholders (and align with the Authority’s 2014 views on problem definition, and the policy remedy (winback ban) advanced by the majority of EPR submitters).
- “We [continue to] want to see distribution businesses adopt tariff reform which supports innovative retail tariff offerings and want a more competitive electricity market.”
- We want to see a fully competitive electricity market emerge: “If the retail market is fixed to ensure a level playing field there is no reason we should remain a “fringe”.”

Concluding remarks

According to Mercury: “With five large retailers innovating and competing and around 30 other retail brands, the electricity sector could well be considered the most competitive of any industry in New Zealand”.²¹ Mercury’s position is comical.

The reality is, as the Authority has recently acknowledged, “the retail market is highly concentrated” and more can be done “to encourage innovation and increase competitive pressure”. We look forward to engaging with the Authority, through the remainder of 2019/20 and then into 2020/21, on workstreams and projects targetted at lifting the level of competition in the electricity sector, which will deliver better long-term outcomes for consumers.

Our focus is on ensuring a level playing field for small and independent retailers²² in both the retail and wholesale electricity segments so that choice and innovation continue to exist for the long-term best interests of consumers [emphasis added]. We, as proudly independent entrant retailers, have delivered choice, innovation and lower prices for consumers.

¹⁸ Electricity Authority, Presentation for Meeting of Regulatory Managers and Consumer Representatives, 22 November 2019, page 15.

¹⁹ Electricity Authority, 2021/21 Levy-funded appropriations consultation paper, 5 November 2019, page 9.

²⁰ Electricity Authority, Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper, 24 June 2014.

²¹ Mercury, Electricity Price Review submission form, Response to the Electricity Price Review First Report, undated.

²² Collectively we represent 8.64% of the electricity retail market, or 96.54% of the electricity retail market supplied by independent retailers.

Yours sincerely,

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