

Friday, 19 January 2018

Submission to MBIE on the Electricity Pricing Review proposed terms of reference

Entrust welcomes the Government's decision to "Hold a full-scale review into retail power pricing".¹

We have noted, in a recent submission to the Electricity Authority, that the Electricity Pricing Review "provides a timely opportunity for an independent body, appointed by the Government, to deal with the competition issues we are concerned about and which haven't been resolved or properly examined by the Electricity Authority".

A desirable outcome for the review would be ensuring regulatory arrangements provide for open competition, with lines companies able to embrace and use new technologies to offer consumers greater choice and drive prices down. It is important to ensure regulation and policy do not obstruct the sector's natural evolution and ability to innovate and embrace new technology.

Entrust wants to ensure electricity is supplied in an efficient and affordable way to all consumers, including the over 327,000 households and businesses in Auckland, Manukau and parts of Papakura and eastern Franklin that are beneficiaries of Entrust.

The Review Panel should be independent

The draft terms of reference are silent on who will undertake the Electricity Pricing Review.

If the Electricity Pricing Review is to be successful it should be set up as an independent Working Group or Panel, just as the Government has done with the Tax Working Group.

The independence of the Review Panel is particularly important given strong vested interests and the potential implications of putting the spotlight on regulatory structures and market conduct. The need for the review, for example, is driven by the Electricity Authority's lack of progress over the last decade in improving competitive market outcomes and choice for consumers.

We would also like to see use of a well-respected international economic expert, or experts, on the Review Panel. The "Vertigan" review of the Australian Energy Markets, for example, was made up of an Expert Panel which included international regulatory expert Professor George Yarrow.

Providing clearer and stronger guidance in the terms of reference

The terms of reference could provide greater guidance on prioritisation than is reflected in the draft. It would help if there were stronger links between the terms of reference and the energy policies of the coalition partners.

¹ Coalition Agreement: New Zealand Labour Party & New Zealand First.

The Electricity Pricing Review originated from NZ First's energy policy which included:

- **Overarching nature of the review:** "Conduct a full Inquiry into high retail electricity prices – recent reviews in the UK and Australia have found major issues with similar 'market reforms' we adopted here." Entrust considers that the Review Panel should be directed to look at these reports and consider their applicability to New Zealand.
- **Regulatory structures:** "Review the Electricity Authority with regulatory functions to be transferred to the Commerce Commission." This provides a clearer direction than the reference to evaluating "the regulatory structures that govern both the competitive aspects of the electricity market and the monopoly aspects ..." in the draft terms of reference.

Entrust supports looking at the respective roles of the Electricity Authority and the Commerce Commission. One model that could be worth considering is telecommunications where the Telecommunications Commissioner has successfully operated within the Commerce Commission since it was established in 2001. Another option would be to provide for the Commerce Commission to be responsible for network regulation (including access arrangements and pricing methodologies), which would enable the Electricity Authority to concentrate on market regulation and promotion of competition.

Other aspects of the coalition partners' energy policies are also relevant to the review, for example:

- **Wholesale market and vertical-integration problems:** While the draft terms of reference direct the Review Panel to look at competition issues, the Green Party energy policy specifically refers to "Conduct[ing] a review of the wholesale electricity markets to make sure small retailers can compete on a level playing field with the big generator-retailers". In addition, the Australian review, which the NZ First policy refers to, found that retail-generation vertical-integration is a barrier to competition by new entrant retailers.
- **The role of local lines companies:** The Labour and Green Parties' energy policies on the role of lines companies are also relevant to the issue of new technology. The respective policies recognise "Lines companies can have a positive role to play in local energy solutions. Such solutions would enable them to better manage traffic across their network especially at peak times, and to avoid costly and avoidable upgrades" and that lines companies should be encouraged to "use new technology to save their customers money".

Challenges the Review Panel will encounter with retail-generation information collection

It will be straight-forward for the Review Panel to get information on financial performance from lines companies and Transpower as this information is publicly disclosed under the Commerce Act Information Disclosure Requirements, and has been since 1994.

Getting comparable information on retail and generation will be more challenging.

We anticipate the Review Panel will face the same intransigence and barriers on the retail-generation side that the Government faced in its retail petrol pricing inquiry. This

could make it difficult for the Review Panel to get accurate and reliable information on retailer and generation excess profitability and margins. In our view the Review Panel would be assisted by a requirement for retailers and generators to provide information equivalent to the public disclosures of lines companies.

There needs to be a specific focus on retail-generation competition issues

Our recent submissions to the Electricity Authority on its 2018/19 Appropriations, and the Commerce Commission in response to its open letter of electricity distribution priorities, highlighted retail and wholesale competition problems which need to be addressed.²

The Electricity Authority appears to have downplayed some of the issues with the way the wholesale and retail markets are operating. An example is the Electricity Authority’s recent response to concerns Vector flagged in the Mass Participation consultation:³

Example of concerns raised about competition	Response by the Electricity Authority
<p>“Vector considers that there is a significant concern with the operation of the wholesale energy market as a few parties can unilaterally exercise power through their ability to withdraw or provide capacity on uncommercial terms.”</p>	<p>“The Authority considers that the wholesale electricity market is workably competitive. This has most recently been demonstrated by the wholesale market response to the dry hydro conditions during winter 2017. ...”</p>
<p>“Vector considers that there is high market share concentration by incumbent retailers. This creates the ability for such businesses to retain cost savings, and not pass these through to customers whether they relate to network charges or lower energy prices. Pioneer raises similar concerns.”</p>	<p>“We note that market concentration in the retail market has significantly reduced over the last 10 years indicating that competition in the retail market is working effectively. ...”</p>

Even where the Electricity Authority acknowledged there are market issues it hasn’t always treated them with the priority they warrant.

For example, the Electricity Authority determined Meridian had used its net pivotal position to raise spot prices, and breached the Code. The Electricity Authority consequently stated it would consider adding a review of the high standard of trading conduct provisions in its work programme but doesn’t appear to have done anything about it. There are clear detriments to customers and other market participants and it is now over 18 months after the incident.

The Meridian Code breach wasn’t an isolated incident. The Electricity Authority decided to discontinue its investigation into whether Mercury’s conduct in December 2016 met a high standard of trading conduct after the parties were unable to reach a settlement. The EA decided not to lay a formal complaint with the Ruling Panel without providing details of its reasoning. The circumstances involved Mercury removing reserve offer capacity which resulted in high final prices for energy and reserves in the North Island.

² These submissions are included as part of our submission on the Electricity Pricing Review Terms of Reference.

³ Electricity Authority, Enabling mass participation: Response and next steps, 4 October 2017, Appendix A, page 12.

The coalition parties' respective energy policies recognised some of the generation and retail market problems. The Green Party policy, for example, noted "the generation and retail market is dominated by large ... generator-retailers", that they are "vertically-integrated", and because of the vertical-integration "they trade internally" which "means there is a lack of transparency about the potential and reality of cross-subsidisation ...". This contrasts with lines companies which are subject to regulatory filings annually on financial performance, including rules on cost allocation and related party transactions.

The Electricity Pricing Review is a timely opportunity to get cut-through on some of the competition issues and serious market power concerns which haven't been resolved or properly examined.

Issues with retail pass-through should be looked at

Our previous submissions have also raised questions about whether network price reductions are fully passed-through to consumers by retailers, which is directly relevant to the Electricity Pricing Review and issues around fairness and affordability. This issue would seem to fit well as an explicit addition to the information collection section of the terms of reference.

Entrust doesn't believe the state of competition in the retail markets is strong enough to ensure retailers fully pass-through any reductions in electricity and gas network prices. We are conscious there are issues with high market concentration, and vertical-integration of the big-five retailers, that could be hampering competition from working properly.

Entrust is uneasy there is no transparency about the extent retailers are passing through network price reductions in electricity and gas, and how quickly pass-through occurs. This is needed if consumers are to have confidence in the market or that they are getting a fair deal from their retail suppliers.

Specific questions for the Electricity Pricing Review

The terms of reference could be enhanced by providing tighter guidance to the Review Panel, and being more consistent with coalition energy policies. One way of addressing the issues Entrust has identified is to add the following questions to the terms of reference:

Regulatory structures

- Would there be benefits from moving Electricity Authority functions to the Commerce Commission?

Information gathering

- What issues are there in obtaining reliable information on the financial performance of suppliers across the supply chain? What changes are needed to resolve this?

Competition

- To what extent are the issues and problems identified in recent Australian and UK reports relevant to New Zealand?
- What is the level of competition in the wholesale and retail markets, including regional retail markets?

- Does retail-generation vertical-integration create barriers to entry, or make it more difficult for stand-alone retailers to compete?
- To what extent are network price reductions passed-through to end-consumers?

Future technologies

- What role can lines companies play in using new technology to save consumers money, and offer consumers greater choice in new technologies and competition?
- Are there barriers to lines companies adopting new technology in place of traditional poles and wire solutions?

Closing remarks

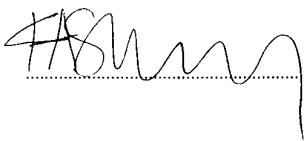
The focus of Entrust's comments are unabashedly beneficiary and consumer focussed.

We want to see stronger and more rigorous competition in the wholesale and retail markets, and the electricity sector more generally. We are aware some retailers want to stifle line companies from adopting new technologies and providing greater choice for end-consumers. If successful these moves would hamper consumer interests and competition.

For further information, contact:

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Kind Regards



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