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Miriam R Dean CNZM QC
Chair
Expert Advisory Panel
Electricity Price Review
By e-mail: energymarkets@mbie.govt.nz

Electricity Price Review – Options Paper

Electric Kiwi and Haast Energy Trading appreciate the work the Expert Advisory Panel has done, in such a short period of time, looking at ways to improve competition and affordability in the electricity sector.

The work of the Panel should act as a circuit breaker for many of the problems in the electricity sector. A characteristic of the current electricity retail market is that it is easy to enter but hard to grow; that is, there are barriers to growth rather than barriers to entry.

The Panel should consider the best way to ensure the reforms are implemented as quickly as practicable, so that all consumers can see the benefits of stronger competition sooner.[1]

There is widespread support for the Panel's proposals

Electric Kiwi and Haast Energy generally support the Expert Advisory Panel's proposals for improving the wholesale market and retail competition (under Options Paper groupings C & D).[2]

Most of the options the Panel is proposing have widespread support and will deliver clear long-term benefits to consumers, from both improved efficiency and reduction in the economic rents incumbent retailers are able to extract from consumers.

The vested interests of ERANZ[3] and its incumbent retailer members means while the Panel can expect majority support it won't get full industry consensus. This is seen vividly with the two-tier market/saves and winbacks issue, and with market making. The incumbent retailers have a half-billion dollars of 'loyalty taxes' per annum that they want to protect and preserve. We encourage the panel to act boldly and with urgency on these issues in the interests of consumers.

The Prohibition of WinBacks and Mandatory Market-Making will deliver the greatest benefits to consumers. These options should be prioritised for urgent implementation:

Prohibition on winbacks and using information from the switching process for any other purpose than facilitating the switch:

We strongly support the proposal to prohibit saves and winbacks and prevent information obtained from the switching process being mis-used to attempt to thwart the switch.

[1] We provide a recap, below, of the problems in the retail and wholesale (hedge) markets to explain why we support the Panel's proposals to improve competition.
[2] Appendices 1 and 2 provide supplementary material and evidence (in support of our First Report submission) of the problems with the level and quality of competition in the electricity market.
[3] The Electric Kiwi, Flick, Pulse and Vocus joint submission to the Electricity Price Review First Report made clear that ERANZ represents incumbent retailer views only, and does not have the support of independent retailers.

The Panel can usefully take comfort from the experience in telecommunications where there is price-led competition and a smaller spread between price tiers. In telecommunications, above the line advertising frequently quotes pricing, while in electricity advertising, price is never mentioned as this would expose the loyalty tax to those paying it. We also note there are useful Australian and UK reviews which the Panel can draw on in support of the need to address 'loyalty taxes' or penalties through restrictions on winback.[1]

It is notable that New Zealand and overseas studies show the consumers most likely to be missing out on the benefits of competition ("stayers") are over-represented by low income and elderly consumers.[4] OFGEM found those that can least afford their power bills are paying the highest prices.[5]

Entrust articulated this well noting "This has real world implications for households and communities" and that the repercussions can include "low income households and the elderly suffering from inadequate heating and all the associated health risks, such as cardiovascular disease and respiratory health problems, that go with it".[6]

Ultimately, while it may be that winbacks result in some customers getting better prices it results in overall higher average prices for consumers, especially those that can least afford it.

Mandatory market-making:

We strongly support this proposal. In the interim, the Electricity Authority should be directed to use section 40 of the Code to immediately implement a mandatory scheme with the following characteristics:

- Covers the current 4 market makers plus at least Trustpower.
- Has the same quoting requirements as the current voluntary scheme.
- Has no "portfolio stress" or similar force majeure clauses.
- Has a mechanism for relaxing bid ask spreads to 10% if a contract has moved more than 20% in either direction over the last 5 trading days.

In the medium term we support the introduction of a Singapore style incentivised market-making scheme. A reverse auction is the best way to incentivise the least cost providers to provide the service. The costs of this scheme could be allocated by the Reconciliation Manager as an Ancillary Service. If all load and generation are deemed to benefit equally from the service it follows that pro-rating costs on a gross MWh basis over load and generation is appropriate. This would mean the additional cost a residential ICP attracts is only a few dollars per year if total costs are comparable to the Singapore scheme.

[4] See, for example, Consumer NZ, Energy providers survey, 7 June 2018.
[5] Ofgem's retail market report for 2016, for example, made the following observations (https://www.ofgem.gov.uk/publications-and-updates/retail-energy-markets-2016):

> We have seen domestic switching rates in 2015 rise to 12% for electricity and 13% for gas - an increase of one and two percentage points respectively on 2014. We have also seen sustained rates of customers switching tariff with their existing supplier. Evidence suggests that much of this can be accounted for by already engaged consumers, who tend to be heavily motivated by price and are most likely to take advantage of competitive fixed-term tariffs.
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> … However, survey data suggests that the overall pattern of domestic consumer engagement in 2016 is largely unchanged relative to 2015 and 2014. More than one in five consumers are very disengaged. They are predominantly on expensive standard variable tariffs, less l kely to engage with information and more likely to be in vulnerable situations.

[6] Entrust, submission to MDAG, A large number of households are missing out on the benefits of competition, 29 June 2018.

Comments on the other EPR proposals

- **Toughen rules on disclosing wholesale market information and prevent insider trading:** We support this measure. The information disclosure issues highlighted in the recent UTS decision expose the failure of the current regime starkly. We believe the behaviour of Genesis detailed in section 9 of the UTS decision is deeply undesirable. The trader aggressively purchased contracts while in possession of detailed non-public information on the Pohokura gas outage and then attributed the trading to a coincidence, arguing a Chinese wall stopped the information disseminating to its trading team. No evidence of a Chinese wall has been provided. A financial regulator would place a much higher burden of proof on the trader to prove a Chinese wall was effective than the Electricity Authority appears to have done.

  Confidence in New Zealand's wholesale markets has been severely shaken by the publication of the behaviour of Genesis, and the failure of the Electricity Authority to act to show that either a robust Chinese wall does exist, or to take action against wrong doing has compounded the break-down in confidence. We believe the following actions are needed to restore confidence in New Zealand's wholesale electricity market:

  - Remove the confidentiality exclusion from section 14.2 of the Code.
  - Direct the Electricity Authority to vigorously enforce information disclosure.
  - Direct the Financial Markets Authority to become the arbiter of insider trading in New Zealand electricity.

- **Ex-post review:** We support the Panel recommending "a high-level review three years after adoption of any recommendations the Government accepts".

- **Ensure regulators listen to consumers:** The objectives of this option might be better achieved by adding obligations on the Electricity Authority to demonstrate how it has taken into account stakeholder views, and how this has impacted on its decisions. (See also comments below on consumer protection.)

- **PPD:** We support the Panel's proposal to prohibit so-called Prompt Payment Discounts, but to allow reasonable, cost-based, late payment penalties provided they are appropriately named and described.

- **Include information on power bills to help consumers switch retailer or resolve billing disputes:** We only support this measure for customers who have a tenure of over 3 years with the same retailer. This will target the measure at the disengaged, overcharged portion of the market. Information on how to resolve disputes (UDL) is already mandatory on bills and requires no further enhancement. It is preferable that retailers proactively manage complaints before a third party intervention is required.

- **Standard terms for network access:** This option is not a priority. Use-of-system agreements aren't a meaningful barrier to entry, as demonstrated by the number of electricity retailers in New Zealand. Market entry isn't the issue, it's having a level playing field for competition that will drive consumer value – things like saves and winbacks have protected the incumbents more than use-of-system agreements. The issues incumbent retailers have raised about use-of-system agreements have more to do with diverting attention away from themselves and trying to blame others (the distributors) for problems in the retail market. Common standards for equipment on networks and consistent pricing approaches are a much higher priority.

- **Distribution and transmission pricing:** We consider there is a need for urgent action on distribution pricing reform.[7] The Electric Kiwi submission to the Electricity Authority on its Electricity Distribution Pricing Principles provides some guidance on potential Government Policy Statement content.[8]

  The Electricity Authority also needs to be stopped from adopting TPM changes which would transfer large amounts of wealth from households to big corporates like NZAS and Meridian. The Panel summed this up well with the question "whether it is generators or residential and business consumers in poorer regions, such as Northland and King Country, that should benefit from lower charges under the Electricity Authority's proposed transmission pricing methodology"? The question should be rhetorical, but under the Electricity Authority review it is anything but. According to Powerco calculation the Authority TPM proposals could cost consumers $74.5m per annum or nearly a billion dollars NPV.[9] Clarification that the Electricity Authority is required to consider wealth transfers from suppliers to consumers would help. (See also comments below on consumer protection.)

- **Consumer protection:** Protection of consumers should be at the heart of any regulatory agency. It is why they exist. There is something seriously wrong if this needs to be spelled out in legislation. The Electricity Price Review could go a long way towards ensuring the Electricity Authority has a consumer-centric perspective, rather than a pure (and theoretical) efficiency perspective, simply by recommending the Electricity Industry Act be amended[10] to include a "For the avoidance of doubt" clause that both efficiency and wealth transfer considerations are relevant to promotion of the long-term benefit of consumers.[11,12] This would help resolve some of the TPM issues and reflect that efficiency is not an end-in-itself.

Policy areas where further investigation is warranted

We consider the Trustpower-TECT arrangements and structural reform options warrant further consideration. Commerce Act action is simply too slow to address the Trustpower-TECT arrangements, while structural reform in telecommunications has been succcessful and is likely to result in bigger improvements to competition than any of the other options being considered (and proposed). Notably, the Electricity Authority Advisory Group, MDAG, concluded that Trustpower has market dominance in the Tauranga region:[13]

- **The Trustpower-TECT arrangements need to be resolved more quickly than possible under the Commerce Act:**[14] This is a rort. We consider that the problems in the Tauranga/Bay of Plenty

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[7] This view is reflected in the joint independent retailer (Electric Kiwi, Flick Electric, Pulse Energy and Vocus) submissions to the Electricity Authority on its 2019/20 work priorities, and to the Electricity Price Review.
[8] Electric Kiwi, submission to the Electricity Authority, Delivering better distribution pricing for consumers, 19 February 2019: https://www.ea.govt.nz/dmsdocument/24835-electric-kiwi
[9] Powerco summed up the negative impact to consumers well with the following observations:

> Even if the Authority's quantified cost-benefit analysis (CBA) is accepted as valid, a net benefit with an NPV of $213m is relatively minor given the scale of wealth transfers. Based on the Authority's own modelling, the price impacts are nearly four times larger than the efficiency impact (-$74.5m p.a. or -$847m NPV). The benefit of $13m NPV from removing the HVDC injection charge based on MWh is relatively immaterial compared to the scale of wealth transfers (-$64.4m p.a. or -$725m) from consumers to South Island generators that would result. It is not obvious why it is in consumers' long-term interests to pay three-quarters of a billion dollars to achieve $13 million in efficiency benefits.

Powerco, Submission on Electricity Authority Transmission Pricing Methodology Review Second Issues Paper, 26 July 2016, paragraph 12, at: https://www.ea.govt.nz/dmsdocument/21037-powerco
[10] Issuing a Government Policy Statement would be another option.
[11] The Commerce Commission recognises this for its responsibilities under Part 4 of the Commerce Act, and the Telecommunications Act.
[12] This option was discussed at the 26 February Panel meeting with some of the independent retailers.
[13] MDAG, SAVES AND WIN-BACKS – RECOMMENDATIONS PAPER, 26 February 2019, paragraph 3.1.5.
[14] Appendix 3 provides supplementary evidence of the nature and extent of problems in Tauranga which support direct intervention over reliance on Part 2 Commerce Act.

retail market warrant more in-depth consideration.[15] Basically, Trustpower is capturing the benefits from trust-ownership rather than consumers (the intended Trust beneficiaries).

While the Expert Advisory Panel has suggested this is a Commerce Act matter, reliance on Part 2 of the Commerce Act is a slow and uncertain process. Even if the Commerce Commission took action, Trustpower would be able to continue to exploit its Tauranga/Bay of Plenty customers for the foreseeable future.

By way of example, the successful 'data tails' case against Telecom related to breaches of section 36 between 2001 and 2004. The case wasn't resolved until 2012 when the Court of Appeal upheld that Telecom breached section 36. In some cases, such as with 0867 and 'data tails' the activity may no longer be a relevant issue by the time the case has been determined. The Panel should seek the Commerce Commission's views about whether this matter can be resolved under the Commerce Act. MBIE is currently looking at making changes to section 36 to resolve some of the problems with it.

- **Further break-up of legacy ECNZ generation assets warrants consideration:** We were dissapointed our proposal for horizontal structural reform of the large generators has not been considered in the Options Paper. Meridian has a disportionately high market share, and at times has effective monopoly power.

  This was an option that garnered a number of supporters, including Entrust, Flick Electric, Pulse, Vector, and Vocus. We consider the Expert Advisory Panel should undertake quantitative analysis to test the impact further break-up of legacy ECNZ assets would have on competition in the wholesale electricity market, including the impact of creating a stand-alone hydro generator that was prohibited from retailing.

  We acknowledge the Panel's concern that this option might be contentious, but it will only become less feasible if not considered now. A politically courageous action now for the benefit on consumers shouldn't be discounted.

- **There are moderate separation options for retail and generation that should be considered as well as financial and full separation:** While our preference would be for full vertical-separation, we are fully supportive of the alternative reforms the Panel is proposing such as financial separation, mandatory market-making and better wholesale market reporting requirements. The Options Paper is silent on the intermediate option of combining financial separation with corporate separation, non-discrimination requirements and/or arms'-length relationship rules. These are moderate reform options, which would help deliver many of the benefits of full vertical separation without requiring major reform and could, potentially, provide a compromise which delivers the best of both worlds.

Electricity reform needs to happen as a matter of urgency

It is important that the necessary changes are implemented sooner rather than later.

We urge the Panel to make clear, time-based, recommendations so improvements to the current system are put in place as soon as possible for the benefit of Kiwi consumers. Current industry behaviours impact on loyal customers and those who can least afford high power prices, such as the elderly and people on low incomes. The loyalty tax alone is costing Kiwi households over half a billion dollars per annum. That needs to change – and change urgently.

A frustration we have is that the wholesale and retail market reforms the Panel is proposing are largely matters the Electricity Authority could and should have addressed already. The Electricity Authority seems to be obsessed with transmission pricing – the impact of which would be to take money off hard-working Kiwis and gift it to NZAS and one of our competitors, Meridian. The last 8

[15] We outline factual details of the problems caused by the Trustpower-TECT arrangements below.

years spent on review of the TPM has come at a large opportunity cost. The TPM review has come at the expense of progressing reforms which would promote competition and better outcomes for consumers. We have raised these concerns directly with the Electricity Authority, including making the point that "there is opportunity for the Authority to show leadership and resolve many of the issues the Price Review is looking at".[16]

We recommend the Electricity Authority be issued directions under section 18 to review adoption of the Electricity Price Review recommendations, with tightly specified process and time-frames. This could be supplemented by a Government Policy Statement directing the Electricity Authority that if the Electricity Price Review recommendations are not implemented in a timely manner through Code changes legislative change will be needed to introduce the electricity reforms.[17]

If legislation is required it will substantially delay consumers seeing the benefits of the reform.

In the last set of electricity industry reforms, section 42 was included in the Electricity Industry Act.

Section 42 directed the Electricity Authority to address seven specific matters, within 12 months or otherwise report back to the Minister of Energy and Resources on why the matters had not been resolved and there hadn't been Code changes.

It should be noted that section 42 does not compel the Electricity Authority, as an independent regulator, to implement regulation for each of the matters it covers.

The difference between now and then is that the Price Review Chair subsequently became the Electricity Authority Chair, and there wasn't a tension between the (then, yet to be established) Electricity Authority's policy positions and that of the Price Review.

The likely tension between the Panel and Electricity Authority views are highlighted by saves and winbacks. The Electricity Authority has released MDAG's draft recommendations on saves and winbacks, which concludes that "the evidence does not indicate material market failures or regulatory problems in relation to saves and win-backs"[18] and that "The Authority should conduct a … survey of consumer experiences of winback behaviour".[19] While MDAG is notionally independent of the Electricity Authority, and the Electricity Authority will need to make its own decisions on the matter, the position on saves and winbacks could not be further from that of the Panel.

The MDAG comment that "Our evaluation is not concerned with direct examination or diagnosis of problems relating to market performance – such as high average prices or distributional concerns"[20] reinforces our view that the Electricity Authority should be directed to interpret its purpose statement to include price (wealth transfer) impacts. One of the biggest benefits to consumers from competition is lower prices. The Electricity Authority's approach of ignoring these benefits creates a substantial regulatory bias against pro-competitive reforms, and risks suboptimal social outcomes for some groups of consumers.

Comments made in the Electricity Authority's UTS decision also clearly indicate the Authority has different views to the Panel about whether mandatory market-making would be to the benefit of consumers, and about wholesale disclosure requirements.[21] The Authority commented, for example, that "before <u>we</u> intervene in the market <u>we</u> must be confident the benefits of any intervention outweigh <u>the costs</u> which, based on overseas experience, <u>may be considerable</u>" (emphasis added).[22] The Authority's commentary was particularly notable given it was made just a week after the Panel

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[16] Electric Kiwi and Haast Energy Trading, submission to the Electricity Authority, Consultation Paper—2019/20 Appropriations and indicative work priorities, 3 December 2019.
[17] This option was discussed at the 26 February Panel meeting with some of the independent retailers.
[18] MDAG, SAVES AND WIN-BACKS – RECOMMENDATIONS PAPER, 26 February 2019, paragraph 4.2.1.
[19] MDAG, SAVES AND WIN-BACKS – RECOMMENDATIONS PAPER, 26 February 2019, paragraph 4.2.5.
[20] MDAG, SAVES AND WIN-BACKS – RECOMMENDATIONS PAPER, 26 February 2019, paragraph 2.6.13.
[21] Electricity Authority, The Authority's decision on claim of an undesirable trading situation, 28 February 2019.
[22] Electricity Authority, The Authority's decision on claim of an undesirable trading situation, 28 February 2019, paragraph 9.99.

released the Options Paper, and had nothing whatsoever to do with whether there was a UTS or the reasons the Authority deemed that there was no UTS.

Taken at face value, the Electricity Authority's UTS commentary on the market performance during period of stress is that the market worked well and there weren't any problems, so it is difficult to see how the Authority would consider anything but minor changes are needed, and or that change would be treated as a priority.

Meridian's statements in Australia support the Panel's proposals

The comments Meridian's 100%-owned subsidiary and retail brands have made about electricity competition issues in Australia sum up well the need for wholesale and retail market reform.

Electric Kiwi and Haast Energy agree with Meridian that "While retail competition has delivered significant benefits, too few customers are experiencing these benefits" with many customers incurring a "loyalty tax ... At a time of increasing affordability issues, such behaviour is unacceptable in an essential service market".[23]

Using its Powershop brand, Meridian has accused other retailers of "bullying", "ripping customers off" and relying on confusion: "We're the power company that does not have ripping customers off at the core of its business plan. Most Australian retailers operate a loyalty tax – the most loyal customers get the worst deal".[24]

Consistent with the concerns raised in submissions on the two-tier retail market, including that of the Commerce Commission, Powershop has submitted that "The business model of [incumbent] retailers relies on charging a loyalty tax to customers who fail to switch and utilising the proceeds of this loyalty tax to subsidise their apparently competitive market offers".[25]

We find it astonishing that Meridian and its 100% owned subsidiary, Powershop, have been vocal in Australia that large retailers are guilty of "bullying" and "ripping customers off'", given Meridian is defending the same thing in New Zealand.

Echoing Telecom's, ex-CEO, Theresa Gattung's comment to an Australian audience that the company is "not being straight up" with customers, and that "It's used confusion as its chief marketing tool. And that's fine",[26] Powershop has also submitted that "All of the confusion in the market place … makes it more difficult for new, innovative retailers to acquire customers, thereby increasing the cost of acquisition and reducing funds available to be passed through as power prices for customers".[27]

Meridian's submission to the Finkel review was clear "Requiring better transparency and discouraging business practices which feed on customer inertia may be part of the solution to this issue, In order to benefit customers, this must be done in a way that helps, rather than hinders competition". [28]

Meridian seems happy to defend the rights of Australian power consumers over their own Kiwi customers. As a largely state-owned business, and custodian of New Zealand's generation assets, we'd expect a greater level of patriotism from Meridian.[29]

[23] Meridian, Submission to the Finkel Review, 2 March 2017.
[24] http://purpose.do/the-power-company-that-encourages-you-to-buy-less-of-what-it-sells/
[25] Powershop, Submission to the Panel for the Review of Electricity and Gas Retail Markets in Victoria, 20 February 2017.
[26] https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10380894
[27] Powershop, Submission to the Panel for the Review of Electricity and Gas Retail Markets in Victoria, 20 February 2017.
[28] Meridian, Submission to the Finkel Review, 2 March 2017.
[29] Electric Kiwi, press release, Meridian Energy Caught Out, 20 August 2018: http://www.scoop.co.nz/stories/BU1808/S00602/meridian-energy-caught-out.htm

Concluding remarks

The retail and wholesale markets are presently oligopolistic in nature, with a long-tail of small entrant retailers. We want the impediments to Electric Kiwi and other independent retailers competing in the electricity retail market removed, so we can compete on a level playing field and consumers can benefit from vibrant competition. The Expert Advisory Panel proposals are a significant step in the right direction.

The proposed options which offer the greatest potential benefits to consumers are:

- **Mandatory Market-Making:** Having a transparent, tradable price curve is essential for the efficient operation of the industry and to level the playing field so independent generators and independent retailers can compete with vertically-integrated businesses.

- **The Prohibition of Saves and Winbacks:** The two-tier retail market enabled by ‘saves and winbacks’ is resulting in an unacceptable wealth transfer between incumbent retailers and customers. Prohibiting saves and winbacks is the single best measure to increase retail competition and put pressure on the price spread between the different tiers.

The Expert Advisory Panel is entirely justified to recommend the options it is currently consulting on. None of the options are genuinely contentious or have any real negative side-effects. The proposed reforms are modest and conservative, and reflect a cautious and incremental response to the problems that have been identified in the review. It will be important that the necessary changes are implemented sooner rather than later.

We urge the Panel to make clear, time-based, recommendations so improvements to the current system are put in place as soon as possible for the benefit of Kiwi consumers.

Yours sincerely,

Luke Blincoe
Chief Executive, Electric Kiwi Ltd
luke.blincoe@electrickiwi.co.nz
9(2)(a) [redacted]

Phillip Anderson
Managing Director, Haast Energy Trading
phill@haastenergy.com
9(2)(a) [redacted]

Appendix 1: Supplementary commentary on submissions about how competitive the New Zealand electricity market is

The incumbent retailers, including their representative body ERANZ, principal submission point was the claim competition in the electricity market is fundamentally working well. These views were supported by the Electricity Authority in defence of its own record in promoting competition. The incumbent retailer claims were notable for being light on facts or serious evidence.

Mercury took the incumbent retailer claims to the extreme, asserting that "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". We are not sure how an oligopolistic market, with a long-tail of small independent retailers, could be described as highly competitive, let alone "the most competitive … industry in New Zealand".

We consider measures that competition regulators base assessment of the competitiveness of markets on, such as market concentration rates, provide a much more reliable picture of how well the electricity market is doing. The Panel has received a large amount of factual evidence on how competitive the market is in response to its First Report.

We note, for example, the information Entrust provided based on New Zealand Commerce Commission and the UK Competition and Markets Authority measures of market concentration. Entrust noted that "The Commerce Commission defines a "concentrated market" as a market where the three firms have a total of 70% or more of the relevant market", and provided concentration ratio information that showed that most regional electricity retail markets are concentrated or close to concentrated.

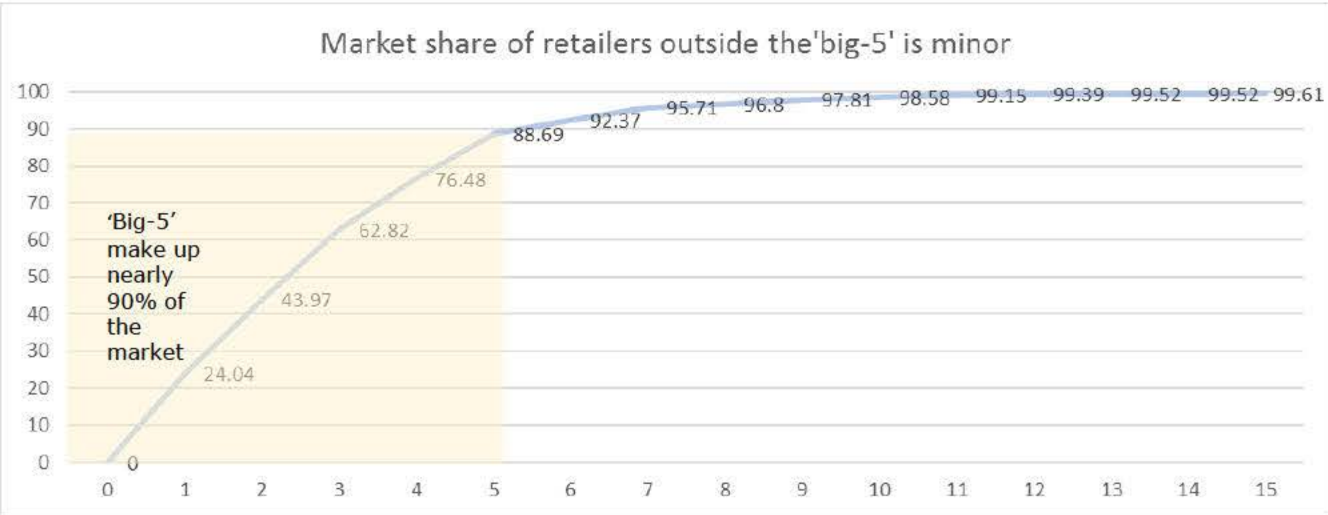
Entrust diagram illustrating market concentration levels in the electricity retail market

Incumbent retailer claims 40 retail brands is a sign of a highly competitive market

ERANZ' claim that "New Zealand enjoys one of the most competitive electricity markets in the world, providing New Zealand consumers more choice" was based on the number of "brands now available to customers … depending on where they live, households have between 14 and 40 retail brands to choose from …" This is a common claim from the incumbent retailers and the Electricity Authority.

ENA and others countered this perspective noting "Of this number, there are 35 small and medium sized retailers which together service 242,929 customers. Of these, 33 have a customer base that is less than a tenth the size of Trustpower - the smallest of the five incumbent retailers". Similarly, Entrust noted "Only four small retailers have more than 1% market share. Most small retailers have less than 1000 customers and many less than 100."

Entrust diagram illustrating that the electricity retail market is dominated by the 'big-5' with a long-tail



Electric Kiwi and Haast Energy have made similar observations e.g. "In the absence of a mid-sized tier of electricity retailers, the New Zealand electricity market will continue to be oligopolistic with high levels of market concentration".[30]

Incumbent retailer claims that independent retailers have made rapid in-roads into the electricity retail market

Contact's position was that:

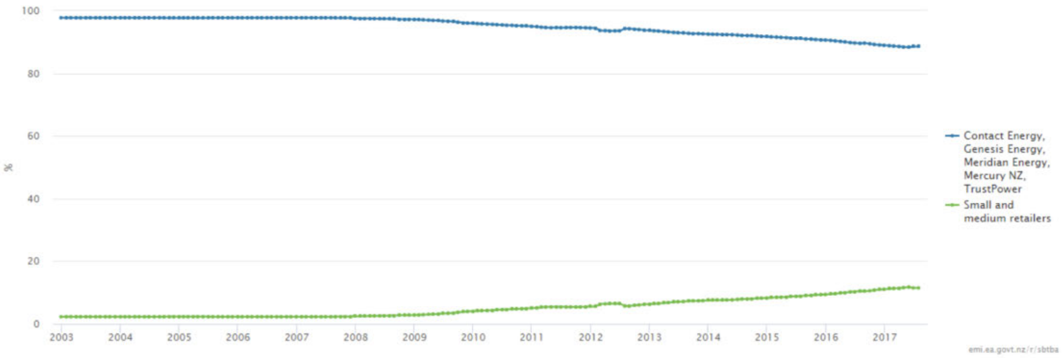
> In terms of barriers to expansion, the Panel cites the Australian regulator's belief that the decline in market share of larger retailers is "slow and doesn't appear to be gathering pace". We would like to know the basis on which this statement is made, and what pace is expected by the Panel. On 15 October 2018 Energy News reported on the September switching data and noted the success of all Tier II retailers in gaining customers from the large retailers. The scale and pace of the Tier II growth is impressive.

In response to this, we note the following:

- Entrust: "Small and new entrant retailers have only gained about 1% market share per annum since the Electricity Authority was established in November 2010 …".

[30] Electric Kiwi and Haast Energy Trading, submission to the Electricity Authority, Consultation Paper—2019/20 Appropriations and indicative work priorities, 3 December 2019.

- ENA: “The following graph demonstrates the trend of slow growth in market share of small and medium retailers:”



Source: EMI retail market share data, Electricity Authority website

It is puzzling that Contact used the same graph and thinks it supports the claim “It would be very difficult to argue that there should have been a greater increase in the number of retailers over the past five years …”.

- Vocus: “The Electricity Authority’s market statistics show the market share of incumbent retailers remains high, with only modest reductions since the last round of electricity reforms and the establishment of the Electricity Authority.”

- Vocus: “Vocus is one of the fastest growing new entrants, but our market share is about 1% after two years of being in the retail market. Electric Kiwi and Pulse have made similar inroads, while other new entrants have flatlined or gone backwards.”

- Vocus: “It took until March 2010 for the small retailers to gain more than 3% market share, after remaining stagnant for a long period of time. Even now the market share of the small retailers is still under 12%. …”

Incumbent retailer claims that the retail market isn’t concentrated

Genesis claimed “Electricity retail market concentration levels … compare favourably against other consumer driven utility markets”.

In response to Genesis’ claim we note the following submission points:

- Entrust: “Small and new entrant retailers have only gained about 1% market share per annum since the Electricity Authority was established in November 2010: 2degrees, in contrast, reached 24% within 4 years of entering of entering the cellular market.”

- Flick: “In contrast to electricity where the Big 5 still hold 90% of the market share, in a much shorter time entrants to the telecommunications market have been able to enter and erode Spark’s market share.”

- Vocus also commented that independent retailer market penetration “… compares poorly against the inroads entrant retailers have made in telecommunications. A comparison of the rate of entrant retailer market penetration in telecommunications versus electricity is a good way of illustrating the challenges the Price Review faces in terms of delivering good outcomes and affordable electricity supply to consumers. Vocus, for example, now has 13% market share in broadband services, more than all entrant retailers in electricity combined”.

- Transpower: “The retail market remains highly concentrated and we have not seen the rate of change observed in other sectors where competition has been introduced, such as broadcasting and telecommunications.”

Appendix 2: Supplementary evidence of worrying developments which heighten the urgency to deal with retail competition issues

There are worrying developments which have and are undermining confidence in, and the integrity of, the electricity market.

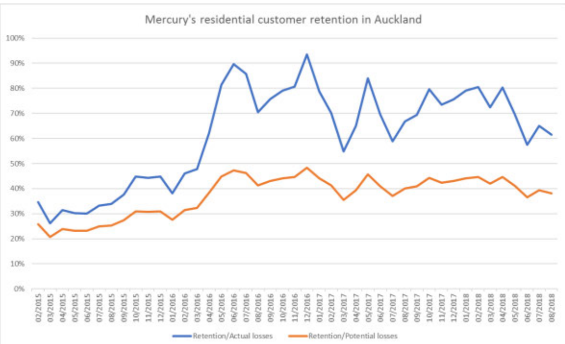
- **The two-tier retail market ('saves and win-backs') is a bigger problem than suggested by the Electricity Authority (MDAG).** We agree with the Panel that "Despite recent growth in competition, a two-tier market is developing in the retail electricity sector. Consumers actively shopping around enjoy the benefits of competition, but those who don't pay higher prices. Our discussions with stakeholders largely confirmed these findings from our first report." We also agree that "…the growing size of price gaps in the retail market" should be of concern.

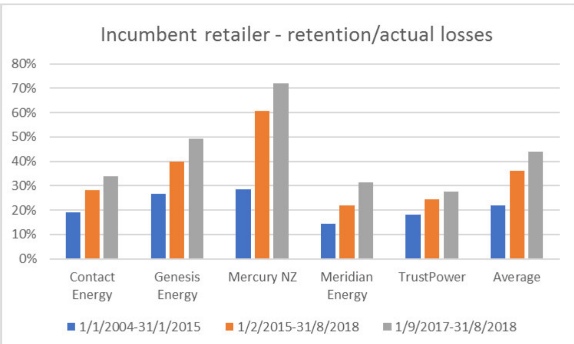
- It is notable Mercury dismissed the Electricity Authority EMI calculation that the level of the loyalty tax was $360m in 2017 alone, on the basis the five incumbent retrailers' retail EBITDAF in FY2017 was circa $400m.[31] At the time Mercury made these statements it provided billing data to the Expert Advisory Panel which demonstrated the EMI data substantially UNDERSTATES the level of the loyalty tax.

Table 1: Estimated average savings ($/year) available to consumers from switching

Region	Savings based on 'X'th percentile			Electricity Authority estimate
	10th	5th	1st	
New Zealand	240	280	400	
North Island	230	270	380	195
South Island	250	310	440	242

- The incumbent retailers didn't just substitute saves for win-backs after the Saves Protection Scheme was introduced, they increased the total level of saves and win-backs (retention) activity.





- **Mis-use of transient market power in the spot market:** The Electricity Authority's review of High Prices on 2 June 2016[32] documented a number of instances where incumbent gentailers have (mis-)used or abused their transient market power (net pivotal position) in the wholesale electricity market to raise spot prices. A troubling part of Meridian's defense is that the practices they employ to manipulate the spot market have been used frequently by themselves and the other incumbent gentailers.

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[31] Mercury, Customer Acquisition, Saves and Win-backs – Cross Submission, 14 August 2018.
[32] Electricity Authority, Market performance review: High Prices on 2 June 2016, 18 December 2017.

- **Lack of hedge market liquidity is holding competition back:** Based on participation in many deregulated wholesale electricity markets around the world, New Zealand stands out as having among the lowest levels of wholesale liquidity relative to its size.[33] The ability of innovative new entrants to enter the market, and gain market share, is severely hampered by the low levels of wholesale liquidity, which is caused by high levels of vertical-integration.

- **Hedge market liquidity is deteriorating:** We welcome the observation that "… the wholesale contract market has recently become increasingly fragile. For long periods in 2017 and 2018, buy and sell price spreads far exceeded the agreed 5 per cent limit – sometimes reaching more than 50 per cent. At the time, hydro storage levels were low and/or gas supplies were short, creating spikes in electricity spot prices. The spikes prompted at least one of the four generator-retailers to withdraw from market-making, citing "portfolio stress". The others quickly followed. This rapidly led to significant price spreads and muffled price signals". We have been raising these concerns directly with the Electricity Authority.

- In the 2017 to present period progress has stalled, traded volumes have stagnated, and spreads have widened sharply. The incumbent gentailers have increasingly tested the appetite of the Electricity Authority to intervene by withdrawing from some of their voluntary market making obligations, and the Authority has not responded forcefully. This has led to progressive withdrawal from the voluntary market making obligations by all 4 of the gentailers in the scheme as they have sensed limited consequences. The market making obligations are now routinely ignored over the front 12 months of the ASX curve, this part of the curve is the most important for hedging and rebalancing for both independent retailers and independent generators.[34]

- The diagrams below show the recent spreads and volume in the monthly ASX contracts as all 4 of the largest gentailers have withdrawn from their obligations over the front 12 months. The contracts for the market making obligations require all 4 market makers to have a maximum of a 5% bid/offer spread.[35]

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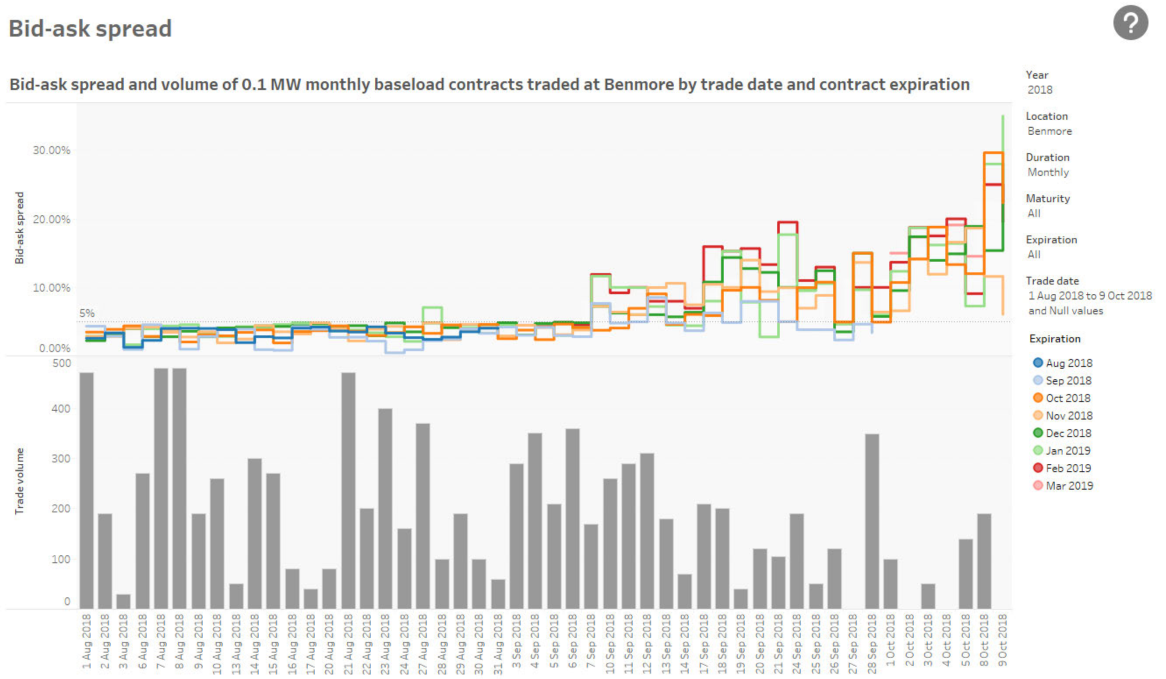
[33] Cumulus, Submission by Cumulus Asset Management on the Consultaiton paper titled – Hedge Market Development: Enhancing trading of hedge products, 14 July 2015, at https://www.ea.govt.nz/dmsdocument/19666

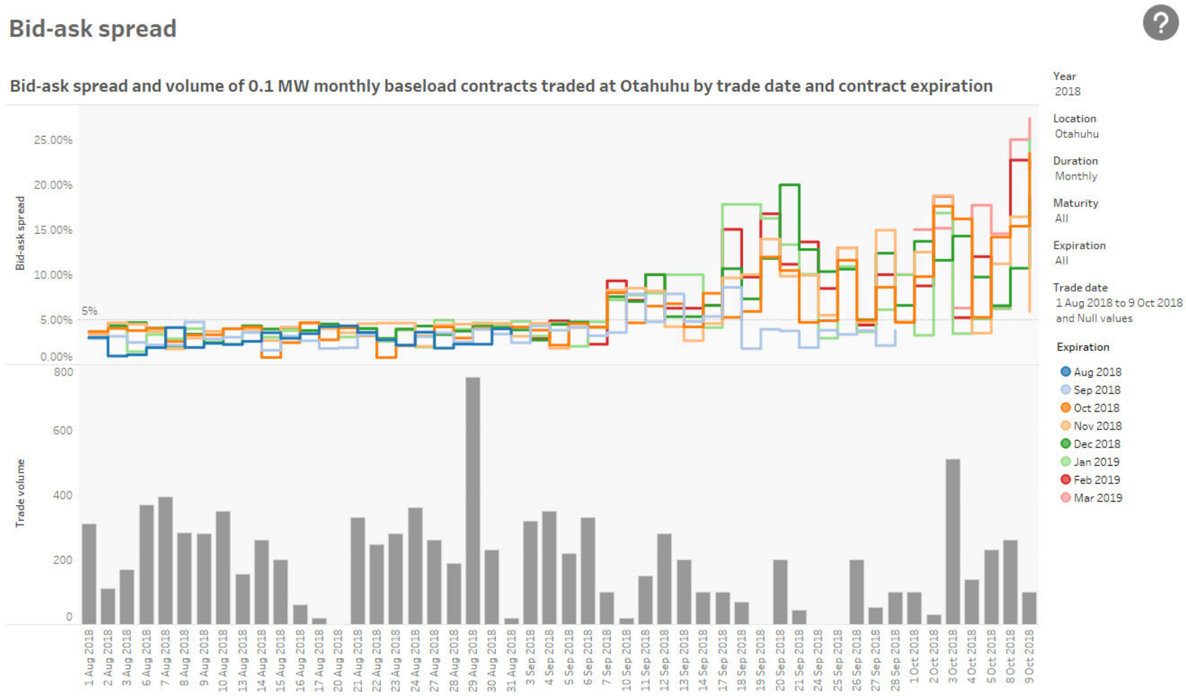
[34] These recent actions by the incumbent gentailers can be understood by the incentives and ability to undermine the hedge market and retail competition which the vertically-integrated incumbent suppliers have e.g.:

- Market making is a cost for vertically-integrated incumbents which they would rather not bear; and

- Market making also increases the competition the vertically-integrated incumbents see in the retail market. If market making collapses and retail competition retreats they will have more market power to extract higher retail prices.

[35] Figures 19 and 20 provided by the Electricity Authority, in response to an information request.





- One consequence of the deteriorating liquidity is that Electric Kiwi was forced to decline to serve the large group of customers on spot based plans who were fleeing the high prices and looking for fixed rate offers late last year. While market fundamentals account for a significant uplift in the cost of acquiring additional hedges that would enable us to accept them, the bid/ask spreads routinely exceeding $100 are adding a significant additional component.

- **Conduct of the vertically-integrated incumbent retailers has lead directly to a blanket UTS complaint for the period from 15 September 2018, continuing as at 8 November 2018:** The UTS results from a confluence of factors; including: (i) potential force majeure events impacting gas supply; (ii) failure of market-making in the contacts market; (iii) sustained atypically high spot prices that appear to be at least partly attributable to the coordinated exercise of market power; and (iv) a blatant disregard for disclosure obligations. We agree with the Panel that "Some generator-retailers may have ignored the Authority's information disclosure rules".

- The failure of market-making obligations in the contracts market and a lack of transparency exposes independent retailers and industrial consumers to the strategic and coordinated exercise of market power by gentailers with natural hedges. Put simply, without adequate contract cover, retailers and consumers are simply wholesale market price-takers. This is problematic in the best of circumstances, but it is many magnitudes worse when supply constraints emerge.

The Electricity Authority's Annual Report shows worrying signs about the hedge market

In normal market conditions, the hedge market is concentrated with all contracts having HHIs between 2,000 and 3,000.

The rise in quarterly HHIs for buyers and sellers in mid-2018 was a result of the dry winter and market makers on the ASX increase spreads. What it shows is that all that is required to turn the hedge market from a concentrated market to a monopoly position (HHI = 10,000) is a moderately dry winter.

This is reflected in the market statistics provided in the Electricity Authority's Annual Report for 2018:

Figure 13: Hedge market concentration for monthly buyers

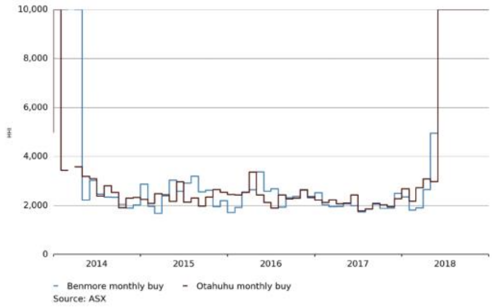


Figure 14: Hedge market concentration for monthly sellers

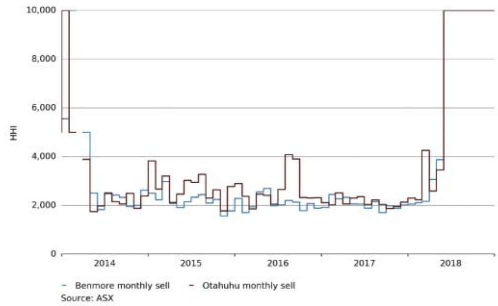


Figure 13.5: Hedge market concentration for quarterly buyers

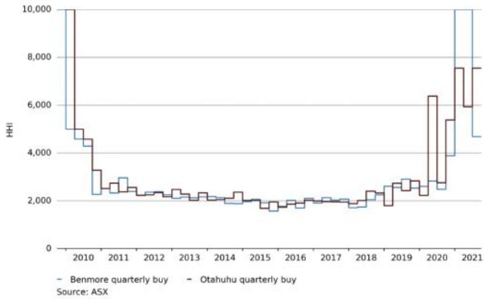
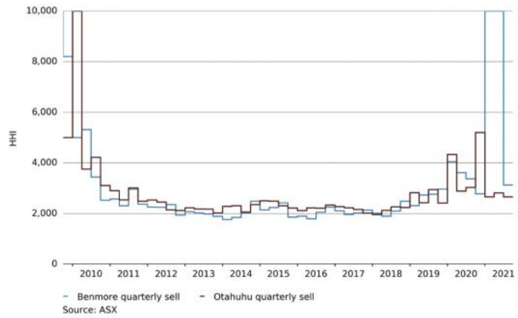


Figure 14.5: Hedge market concentration for quarterly sellers



Appendix 3: Supplementary evidence of problems with The Great Wall of Tauranga

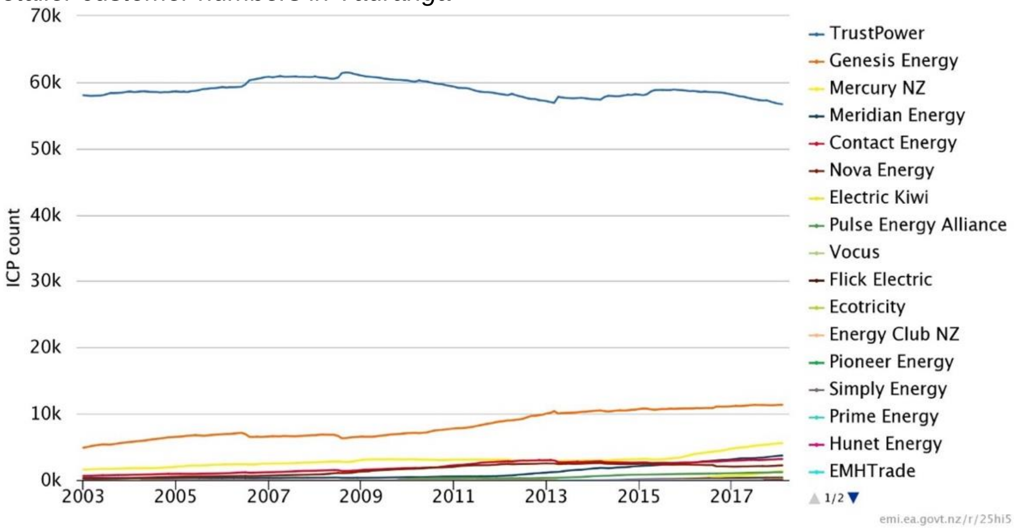
While the level of retail competition varies amongst network areas, and is generally concentrated, the glaring problem remains Tauranga and the Trustpower-TECT arrangements. We agree with submissions that "… retail competition in the western Bay of Plenty was undermined by how the Tauranga Energy Consumer Trust distributed benefit".

We think it could be useful for the Panel to contrast Trustpower's retail market performance in Tauranga with other regional retail markets.

Tauranga has retained market share in Tauranga, but its market share is in free-fall in neighbouring areas where it isn't protected by Trustpower-TECT arrangments

Trustpower's customer numbers in the Tauranga network region is virtually unchanged over the last 15 years. Trustpower had 58,029 customers in 2004 and, now, still has 56,672. A drop in customers of 2% over 15 years is not the sign of a healthy retail market. It is the sign of a monopoly market.[36]

Retailer customer numbers in Tauranga



The difference between Trustpower's retail market performance in Tauranga could not be more stark with its performance in neighbouring Rotorua and Taupo where Trustpower also started out as the incumbent.[37] Rotorua is one of the few areas in New Zealand where the incumbent retailer is no longer the largest retailer. The difference in market outcomes can be entirely attributed to the Trustpower-TECT arrangements.

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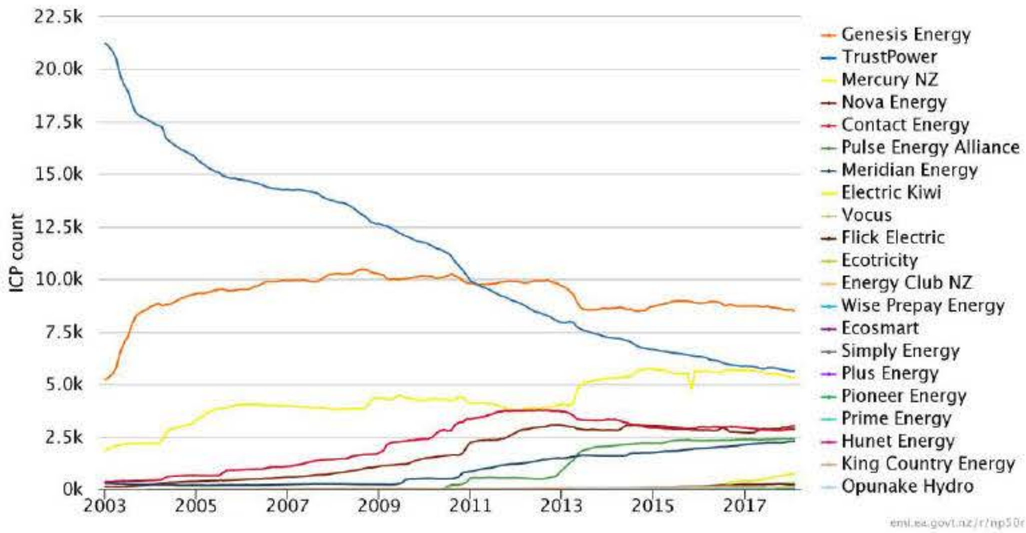
36 https://www.emi.ea.govt.nz/Retail/Reports/R_MST_C?DateFrom=20040101&DateTo=20190131&RegionType=NWK_REPORTING_REGION_DIST&_rsdr=ALL&RegionCode=10&_si=tg|market-structure,v|3

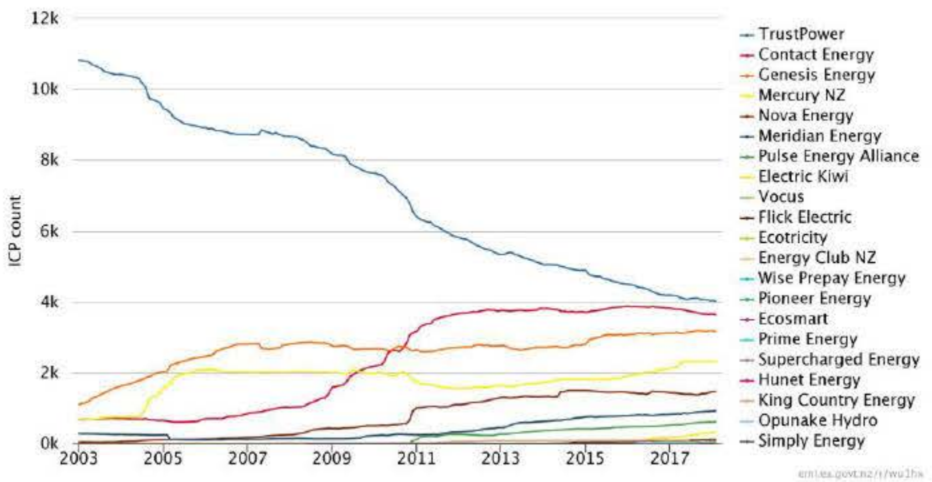
37 https://www.emi.ea.govt.nz/Retail/Reports/R_MST_C?DateFrom=20040101&DateTo=20190131&RegionType=NWK_REPORTING_REGION_DIST&_rsdr=ALL&RegionCode=11&_si=v|3

Retailer customer numbers in Rotorua



There is a similar story in Taupo where Trustpower is on the cusp of losing its incumbent (largest) retailer status.[38] Trustpower has the record of highest market share of any incumbent retailer in Tauranga, and lowest market share of any incumbent in Taupo.

Retailer customer numbers in Taupo



The only positive is that Trustpower's hopelessness as an incumbent retailer in areas where it cannot take advantage of the Trustpower-TECT arrangements has resulted in substantial drop in HHI and market concentration statistics.

Comparison of Trustpower's performance in Central North Island regions where it is (or was) the incumbent retailer

	Rotorua	Taupo	Tauranga
Change in market share (2004 – 2019)	-52.51%	-55.26%	-22.7%
Market share (CR1)	27.02%	24.01%	65.71%

38 https://www.emi.ea.govt.nz/Retail/Reports/R_MST_C?DateFrom=20040101&DateTo=20190131&RegionType=NWK_REPORTING_REGION_DIST&RegionCode=13&_rsdr=ALL&_si=v|3

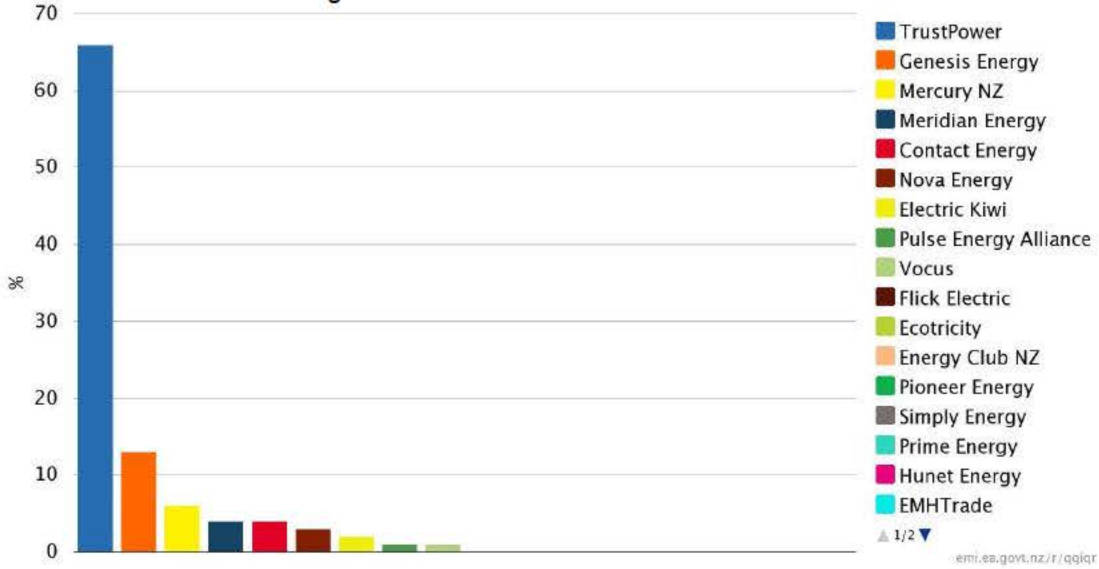
	Rotorua	Taupo	Tauranga
Market Share (CR2)	44.9%	45.07%	78.86%
Market Share (CR3)	61.75%	64.59%	85.3%
HHI	1,625	1,719	4,575
Energy margin	18.58c/kWh	18.52c/kWh	20.89c/kWh
Loyalty tax (2017)*[39]	$271.51	$267.26	$443.93

* EMI underestimate

High market concentration in Tauranga

Trustpower's market share in the Tauranga network region remains at 65.7%[40] for all consumers, and 66.54% for residential consumers as at 31 January 2019.[41] Genesis Energy is the only retailer that has managed to get any traction in the Tauranga market and its market share is just 13.16%. The gain in customer numbers by retailers other than the incumbent, Trustpower, mirrors the population growth in the region.

Retail market share in Tauranga



Market concentration problems in Tauranga

The Tauranga electricity retail market scores abysmally on any of the standard competition or market concentration measures, in both absolute and relative, terms:

- Switching rates in the 12 months to 31 January 2019 was 15.35%, which was only slightly better than Waitaki at 14.71%.

- The HHI is the highest in New Zealand at 4,574.[42] The HHI for residential consumers is higher still at 4,693.[43]

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[39] https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NWK_REPORTING_REGION&Show=Avg&_si=tg|residential-savings,v|3

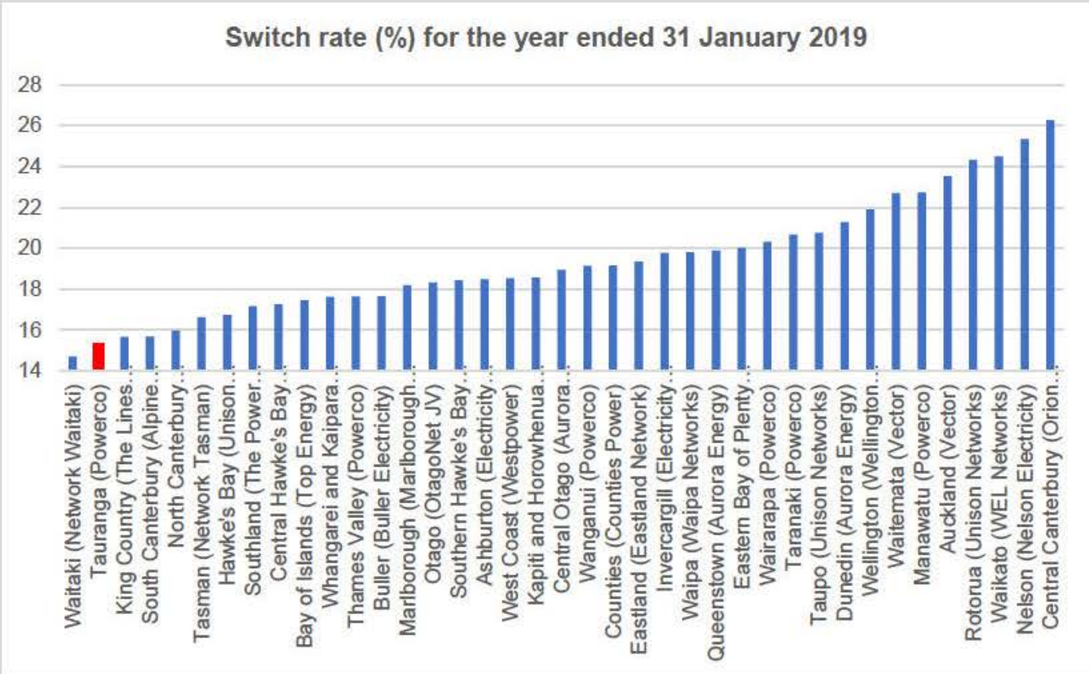
[40] https://www.emi.ea.govt.nz/Retail/Reports/R_MSS_C?RegionType=NWK_REPORTING_REGION_DIST&RegionCode=10&Percent=Y&_si=tg|market-structure,v|3

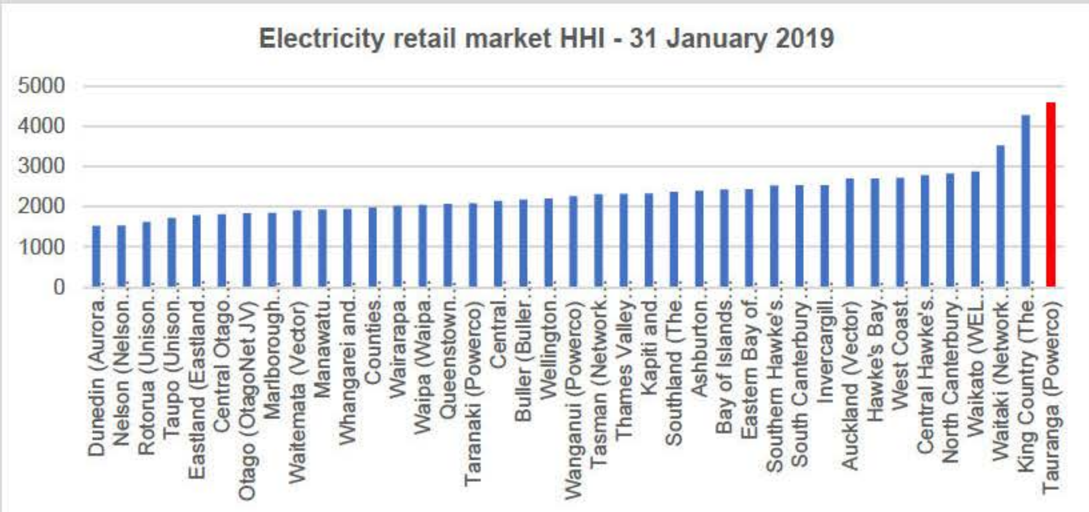
[41] https://www.emi.ea.govt.nz/Retail/Reports/R_MSS_C?RegionType=NWK_REPORTING_REGION_DIST&RegionCode=10&Percent=Y&_si=tg|market-structure,_dr_RegionType|NWK_REPORTING_REGION_DIST,_dr_RegionCode|10,_dr_MarketSegment|Res,v|4

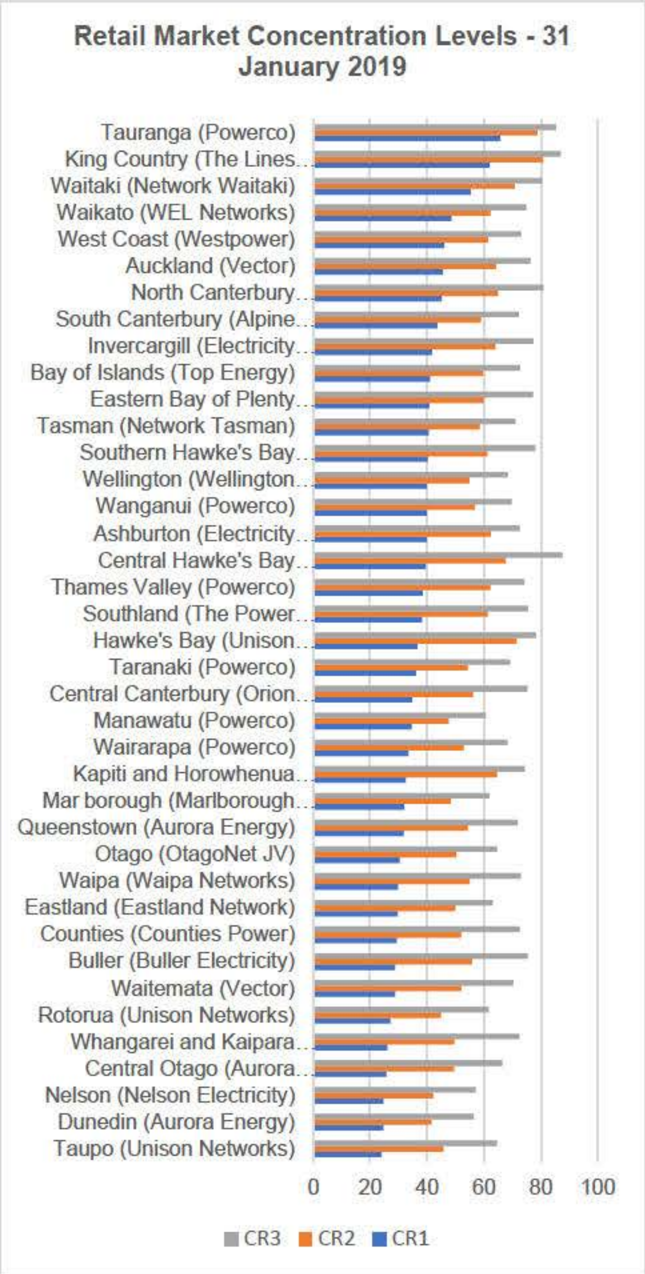
[42] https://www.emi.ea.govt.nz/Retail/Reports/IK41HT?_si=tg|market-structure,v|3

[43] https://www.emi.ea.govt.nz/Retail/Reports/IK41HT?_si=tg|market-structure,v|3

- Trustpower's market share in Tauranga is 65.7%, which is higher than any other retailer in any other network reporting region in New Zealand. The market concentration of the two largest retailers in Tauranga is 78.86%, which is higher than in any other network reporting region in New Zealand apart from King Country (80.75%).



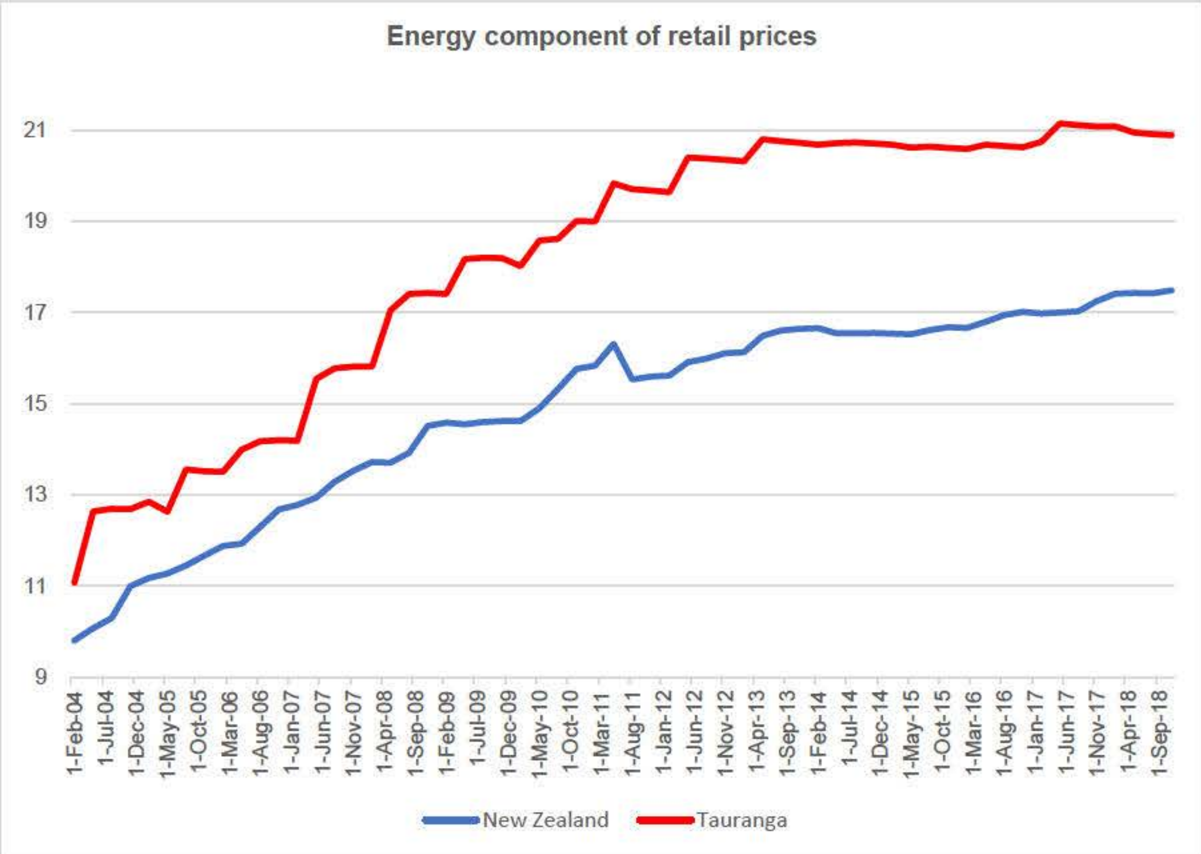


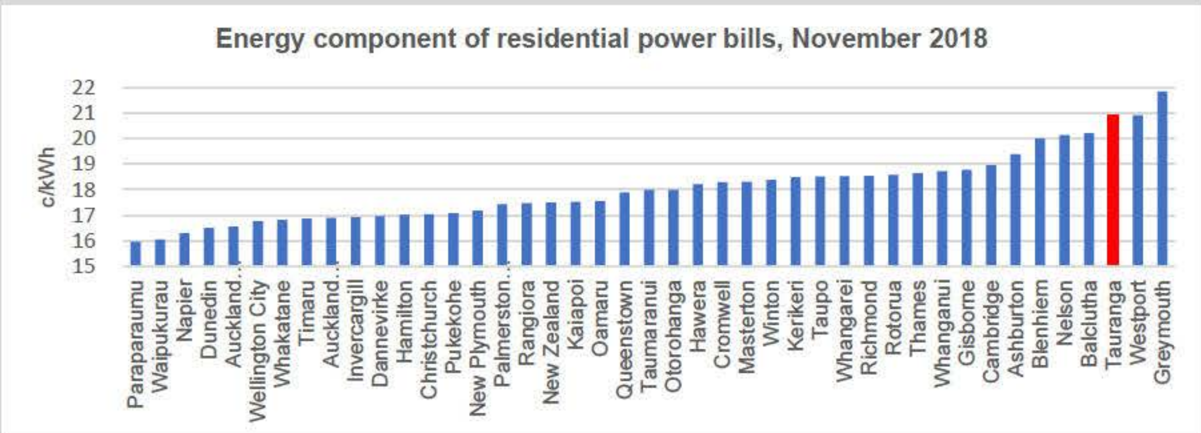


Evidence of retail monopoly pricing by Trustpower in Tauranga

The barriers to competition in Tauranga have meant Trustpower has been able to maintain monopoly pricing.

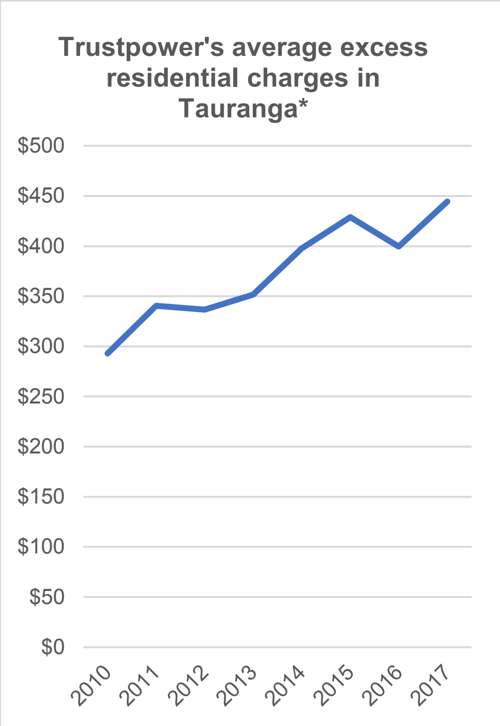
The energy component of retail prices in Tauranga has grown at a higher rate than the rest of the country. In 2004 the energy component was 13% higher, and it is now 19% higher. The only towns with higher energy charges are Westport and Greymouth.

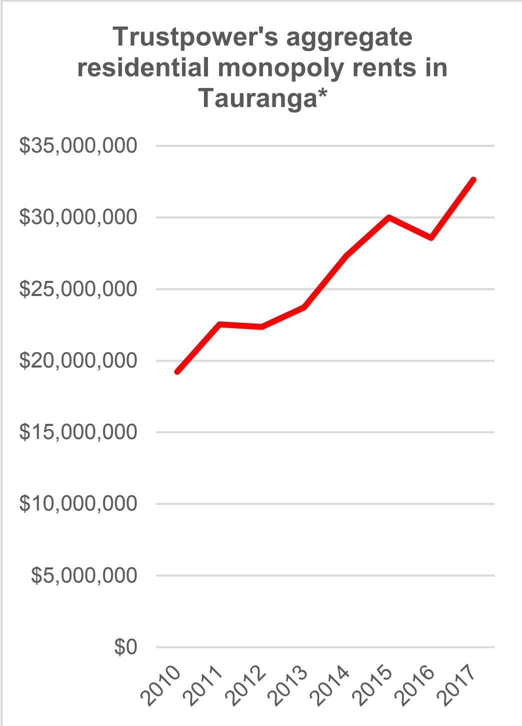




The level of loyalty taxes (measured as the difference between Trustpower's prices and the lowest priced competitor) is the highest in the country, and over twice the national average.

The Expert Advisory Panel has determined that EMI data substantially understates the level of level of Trustpower's residential loyalty taxes, but even with the understated estimate the loyalty tax went up from just over $290 per annum in 2004, to nearly $445 in 2017. This equates to overpricing for residential customers in the Tauranga region alone of $35 million per annum. The accumulative tax Trustpower has imposed on residential customers, in Tauranga, over the last 8 years is over $200 million. We suggest that the Expert Advisory Panel calculates a corrected version of the loyalty taxes.





* Understatement based on EMI data.