



22<sup>nd</sup> March 2019

## ABOUT VOCUS

1. Vocus New Zealand is the third largest fixed line telecommunications operator employing over 800 staff in New Zealand. Our retail operation includes a number of challenger brands - Slingshot, Orcon, Flip, CallPlus and 2Talk. We are also an active wholesaler of telecommunications services including access, voice and broadband over both fibre and copper.
2. Vocus has made significant investments in New Zealand. We are the largest copper unbundler with a presence in over 200 exchanges throughout New Zealand. In addition we operate 4,200km fibre optic network transits between virtually all major towns and cities, and connects directly into all major peering exchanges.
3. Our 200,000+ customers in New Zealand range from government agencies, integrators, large corporate, SME and residential households. We are committed to New Zealand's fibre future.
4. Vocus is committed to New Zealand and is one of the few large NZ telecommunications companies to base all its customer service call centres here in New Zealand rather than outsourcing its customer service operations overseas.
5. Vocus Group is one of the fastest growing telecommunications companies in Australasia and a major provider of voice, broadband, domestic and international connectivity and data centers throughout New Zealand and Australia.
6. Vocus Group bought New Zealand electricity retailer Switch Utilities in December 2015 and since May 2016 has retailed electricity under the Slingshot, Orcon, Vocus and Switch Utilities brands. During this time Vocus has acquired some 16,000 ICPs through various marketing channels and upselling to our telecommunications customer base.
7. Thank you for the opportunity to make this submission. If you would like any further information about the topics in this submission or have any queries about the submission, please contact:

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## Submission on Electricity Price Review Options Paper

Dear Miriam,

1. Vocus welcomes the Electricity Price Review's preliminary Options Paper. We appreciated the opportunity to meet and discuss our views on 26 February, and at the subsequent 13 March workshop.
2. Vocus supports the predominant focus of the Options Paper on retail and wholesale market competition issues. This continues the focus on competition issues from the First Report. The issues we raised in our First Report submission predominantly related to how the conduct of the large incumbent retailers is detrimental to the development of competition and consumer interests. A large number of submissions followed a similar theme, including that of the other independent retailers, the ENA, and various of the ENA's members (and their Trust shareholders). We also acknowledge the Commerce Commission's concern about potential anti-competitive impact of win-backs.<sup>1</sup>
3. Leaving aside the views of the Electricity Authority and the incumbent retailers, the Panel should have confidence there is a high level of agreement around the competition problems in the electricity market, and the types of remedies which should be considered.

### Key questions to consider in finalising recommendations to the Minister

4. Vocus would like the Panel to consider the following matters while it deliberates on the final elements of the price review and the recommendations it will make to the Minister:
  - a) **What does successful reform of the electricity market look like?** How much further down the OECD rankings will New Zealand slip if the reforms aren't successful? On the basis of current trajectories, in 9 or 10 years time the 5 largest retailers will still have 80% market share. According to Electricity Authority data the level of retail-generation vertical-integration has hovered stubbornly in the mid-high 80% range, with no sign of letting up.
  - b) **What needs to be done to bring ahead the reforms more quickly, and faster than would be possible if legislative change is needed?** The Electricity Authority could implement most of the pro-competition reforms before the Panel finalised its recommendations to the Minister if they were minded to.

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<sup>1</sup> Various stakeholders like the Commerce Commission engaged on the two-tier retail market/saves and winbacks issue who had not engaged in the Electricity Authority/MDAG review.

- c) **Related to the above, what reforms will deliver the biggest ‘bang-for-buck’?** Vocus considers that a full ban (not a trial ban) on win-back, mandatory market-making and tougher wholesale disclosure rules are the most important reforms for promoting a healthy-competitive electricity market, followed by financial separation. A ban on win-back would not only reduce average retail prices, but it would also lower retail prices for lower income and vulnerable consumers.
- d) **Does it make sense for the Electricity Authority and Commerce Commission to adopt different interpretations of the objective to promote competition for the long-term benefit of consumers?** Under the Telecommunications Act, the Commerce Commission has made decisions, such as to promote competition by regulating Mobile Termination Rates, largely on the back of the benefits of wealth transfers (lower excessive returns) from incumbent suppliers to end-users. The Electricity Authority’s sole focus on efficiency means it ignores benefits to consumers from lower prices when it considers regulation. The creates a regulatory bias against reforms that would promote competition and improve consumer welfare (long-term benefit of consumers).
- e) **Should the Panel believe claims (Sapare etc) that win-backs are part of competition?** The Electricity Authority Advisory Group’s, MDAG, position that saves and winbacks isn’t a problem is out of step with not only the Panel, but also the ACCC and the UK Competition and Markets Authority (CMA).<sup>2</sup>

A simple test to determine whether win-backs are to the long-term benefit of consumers is to ask whether they result in higher or lower average residential prices. The UK CMA asked itself this question, looking at a broad range of industries, and concluded win-backs resulted in higher overall prices.<sup>3</sup> MDAG has ignored such matters in its consideration of win-backs which has meant it has ignored the main two-tier retail market problem a ban on win-backs would help address.

- f) **Should claims that mandatory market-claiming has high costs be taken seriously?** What about the costs of not intervening? The Electricity Authority’s UTS decision stated that “*based on overseas experience*” the costs “*may be considerable*”.<sup>4</sup> Experience in Singapore does not seem to bare this claim out, and the Authority and others haven’t corroborated the claims.
- g) **What should financial separation rules look like?** ERANZ and the incumbent retailers advocated the need for tight cost allocation and related party transaction rules during the Commerce Commission’s Input Methodologies review. These submissions and the Commerce Commission decisions should provide helpful precedent and guidance.
- h) **If structural reform of the retail-generation market is a step to far, should moderate enhancements to financial separation such as Operational Separation and arms-length rules be considered?** While Operational Separation is a second best option it is a less interventionist option which worked well in telecommunications prior to (voluntarily agreed) full separation.
- i) **Why have retail price caps been introduced in jurisdictions such as the UK?** Vocus doesn’t support this type of intervention. It would harm the prospect of retail competition developing the way it should. This kind of intervention can end up being introduced if

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<sup>2</sup> We were surprised the MDAG draft recommendations paper on saves and win-backs didn’t even make mention of the CMA report.

<sup>3</sup> <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

<sup>4</sup> Electricity Authority, The Authority’s decision on claim of an undesirable trading situation, 28 February 2019, paragraph 9.99.

competition policy fails and consumers lose confidence in the market. There will be a higher risk of this higher risk if the status quo is retained and reforms such as ban on win-backs and mandatory market-making aren't introduced. We consider that there already has been a drop in confidence in the market, as reflected in the 2018 UTS complaint.

## **Vocus considers that the wholesale and retail market reform proposals will result in better competition and lower prices for consumers**

5. Vocus generally supports the Expert Advisory Panel proposals to promote greater competition.<sup>5</sup> We would like to see the retail and wholesale reforms expedited in a timely manner. Our support is subject to the following qualifications and observations:
  - a) **Standard use-of-system agreements:** The experience with network access issues in electricity is quite distinct from telecommunications. We do not consider standardisation of network access arrangements should be treated as a priority.<sup>6</sup> In the 1990s retailers in the telecommunications market were vocal about a long list of access issues, but the same can't be said of the electricity industry.
  - b) **Mandatory market-making:** If the Panel favours the Singapore market-making model there is no reason it should take as long to develop and implement as it did in Singapore. New Zealand can leverage off the work done in Singapore.
  - c) **Trustpower-TECT arrangement in Tauranga:** Our experience with Part 2 Commerce Act cases in telecommunications is that they are slow and uncertain (data tails and 0867 being two examples). This would not be satisfactory for consumers in Tauranga. The establishment of the Telecommunications Commissioner and the Telecommunications Act 2001 had its origins in problems with reliance on the Commerce Act, and the CLEAR versus Telecom section 36 battles in the nineties. It is notable that MDAG has suggested Trustpower has market dominance in the Tauranga (and King Country) retail markets.
  - d) **Adding protection of consumer interests to the Electricity Authority's functions:** Vocus considers that a better way to ensure the Electricity Authority's decision-making is consumer-centric would be to clarify the Electricity Authority (under the Electricity Industry Act) and Commerce Commission (under Part 4 Commerce Act and the Telecommunications Act) are required to both interpret the statutory objective of promoting the "long-term benefit of consumers" to include benefits from efficiency gains and wealth transfers from suppliers to consumers.<sup>7</sup> This would mean the Electricity Authority would take into account both the benefits to consumers of efficiency gains (reduction in costs) and lower excessive profits. Consumers benefit from lower prices (or prices that are lower than otherwise) regardless of whether this is due to efficiency gains or wealth transfers.

## **Widespread support from First Report submissions**

6. The options the Panel has proposed to strengthen competition have broad support, based on the submissions on the First Report:
  - a) **Win-back ban:** There was a higher degree of engagement on the two-tier retail market (saves and win-backs) issue than there has been through the Electricity Authority (MDAG) review process. Additional independent retailers and various of the electricity networks (ENA,

<sup>5</sup> For the avoidance of doubt, this includes the proposal to explore options for bulk tender for social housing and Work and Income clients.

<sup>6</sup> There would be some efficiency gains if all the EDBs provided data in the same format.

<sup>7</sup> We raised this option at the 26 February meeting with the Panel.

Northpower, Top Energy and Vector), and the electricity trusts (Counties Power Consumer Trust, Entrust and Waitaki Consumers Trust), that hadn't previously submitted on the topic, all advocated for restrictions on win-backs.

The Commerce Commission also raised the potential that some retention activity could be anti-competitive: *"A competition concern could arise where the use of win-back discounts result in customer foreclosure and raising rivals' costs" and "discounts may be targeted at the high value customers, so that challenger retailers end up with disproportionately low value customers"*. While Consumer NZ argued *"Requir[ing] retailers to publish all available prices ... would avoid the need to regulate in regard to "win backs""* the Panel has ruled out this option.

At the 13 March workshop, Vocus noted that, notwithstanding the rules in telecommunications, the outcome is that win-backs don't happen due to third party install costs and CPE means that telecommunications RSPs assume once a customer is lost they are gone. This breeds behaviour of treating customers well, adding value and proactively managing prices meaning that we don't have a two-tier customer base of those who have been switchers and those who haven't.

Vocus notes there were suggestions at the workshop that pilots or regional trials of win-back bans could be conducted. Vocus does not support such an approach and considers that there should be full introduction to a win-back ban. We would support a Post-Implementation Review though.

- b) **Retail-generation financial separation and disclosure requirements:** Genesis proposed retail and generation financial disclosure requirements, including *"details of the transfer pricing by generator-retailers between their generation and retail segments, a baseload equivalent for Commercial & Industrial (C&I) Fixed Price Variable Volume (FPVV) products and disclosure of segment contributions from generation / wholesale operations"*.

We also note ERANZ and the incumbent retailers engaged substantively on the Commerce Commission's review of its cost allocation and financial separation rules in the Part 4 Input Methodologies. These submissions provide relevant precedent for retail-generation financial disclosure and cost allocation. In particular, we note concerns raised by the ERANZ and the incumbent retailers about application of the avoidable cost allocation methodology (ACAM) and optional variation accounting based allocation approach (OVABBA), and the preference for an accounting-based allocation approach (ABAA).<sup>8</sup>

- c) **Mandatory market-making:** While there were different views about how well the hedge market is working, there was support for reform. Meridian, reflecting its self-interest, advocated for minor change only suggesting that *"Strengthen[ing] the current voluntary ASX market-making arrangements by introducing greater incentives for market-makers"*.

We agree with Transpower *"Third parties should be able to negotiate for competitively priced hedges on equal terms to parties in common ownership (open access)"* and there is a need for *"providing much needed liquidity in derivative products through mandatory market-making obligations on the large gentailers ..."* We also agree with Vector that *"New Zealand stands*

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<sup>8</sup> See, for example: Contact, Input Methodologies Review – updated draft decision on cost allocation, 13 October 2016 [misdated 12 August 2016], at: [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0023/60197/Contact-Energy-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF](https://comcom.govt.nz/__data/assets/pdf_file/0023/60197/Contact-Energy-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF)

ERANZ, SUBMISSION TO THE COMMERCE COMMISSION ON UPDATED DECISION ON COST ALLOCATION FOR ELECTRICITY DISTRIBUTION BUSINESSES, 13 OCTOBER 2016, at: [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0025/60199/ERANZ-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF](https://comcom.govt.nz/__data/assets/pdf_file/0025/60199/ERANZ-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF)

*out among international electricity markets as having some of the lowest levels of contract market liquidity ... Liquidity indicators such as bid-offer spreads and contract churn rates are an order of magnitude below markets such as the UK, PJM and even Australia ...”*

- d) **Low Fixed Charge Regulations:** The Low Fixed Charge Regulations came in for near universal criticism with most submitters wanting the regulations to be abolished.

## **UK ‘Loyalty penalty’ super-complaint provides relevant new information to the two-tier market/saves and win-backs issue**

7. As we mentioned at the 26 February meeting with the Panel, the UK ‘loyalty penalty’ super-complaint is directly relevant to the affordability and competition issues the Panel is grappling with (and likewise the MDAG review of saves and win-backs).
8. Citizens Advise made a “*super-complaint*” to the UK Competition and Markets Authority (CMA) that not enough has been done to tackle loyalty penalty issues in 5 markets: mobile; broadband; cash savings; home insurance and mortgages.<sup>9</sup>
9. The CMA investigated concerns that people who stay with their provider can end up paying significantly more than new customers. The CMA findings were that:

“Overall, we have found that the loyalty penalty is significant and impacts many people, including those who can least afford it. Customers rightly feel ripped off, let down and frustrated. They should not have to be constantly ‘on guard’ or spend hours negotiating to get a good deal. This erodes people’s trust in markets and the system as a whole.”

“Some people wrongly believe that staying will pay off in the long term, do not know they could make significant savings or have other things to worry about, so do not even think about switching. It can also be confusing and time consuming to shop around, and suppliers can exacerbate these problems.”

“The loyalty penalty is of greatest concern when:

- It is particularly concerning when those that suffer are vulnerable, where they are unable to act to avoid the penalty, or they are not aware of it.
- it involves confusing or misleading customers, leading to poor decision making or undermines trust in markets;
- market characteristics suggest it is likely to increase average prices for consumers;
- it leads to harmful distributional effects;
- the product or service is considered ‘essential’ or constitutes a large proportion of people’s expenditure.”

“Robust estimates of the loyalty penalty in different markets are of clear value to regulators. It would help them to decide which markets they should investigate further and enable them to evaluate the impact of their interventions on the size of the loyalty penalty over time or for particular groups of consumers. In addition, we believe there is a strong case for regularly publishing estimates of the loyalty penalty. This can incentivise companies applying the loyalty penalty to change their behaviour, inform public debate and raise general awareness.

“Reputational incentives can be a powerful force in recognising and rewarding good conduct and discouraging exploitative behaviour or unsatisfactory performance. The potential impact on businesses’ brand value of reputational harm can focus minds at board level. Publishing business-level estimates of the loyalty penalty, and the associated media coverage and customer awareness, may prompt suppliers to offer better deals to longstanding customers and reduce the price differential in order to build a good reputation.

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<sup>9</sup> <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

“We therefore recommend that regulators should collect and publish indicative metrics on the existence and size of the loyalty penalty (ie price differences or number of longstanding customers) on a regular basis (such as annually, through for example a loyalty penalty report). ...”

10. It is notable CMA didn't recommend a single 'silver bullet' to address the loyalty payment issue. The recommendations included 'name and shame' (through disclosure of loyal penalties), as well as initiatives the Panel favours such as collective switching.

### **Structural solutions warrant consideration for structural problems**

11. We were disappointed that while the Options Paper did not favour full vertical separation, and instead proposed financial separation, there was no mention of moderate, intermediate, options such as operational (corporate) separation, non-discrimination requirements and arms-length rules. The Options Paper was also silent on horizontal separation of generation assets.
12. A number of submitters, e.g. Ecotricity and Flick, as well as ourselves, commented favourably on the experience in telecommunications with the separation of Chorus (wholesale) and Spark (retail). Ecotricity, for example, noted that *“As was seen in the telecom market some 7 years ago, when Telecom was split into Spark and Chorus, telecom costs to the consumer dropped significantly”*.
13. We acknowledge the Panel's qualification that some solutions the Panel doesn't favour *“may warrant reconsideration if the ones we do favour ... turn out not to deliver the expected improvements”* and *“separation will be unnecessary if the other four options are successful”* (emphasis added).
14. Vocus supports the intention that the *“... final report will recommend a high-level review three years after adoption of any recommendations the Government accepts”*. It will be important the Panel is clear about what the *“expected improvements”* would be from the reform proposals, to aid the ex-post review.

### **Vocus supports abolishing the Low Fixed Charge Regulations with a rapid transition**

15. Vocus' submission on the First Report highlighted how issues with the Low Fixed Charge Regulations are getting worse, with the value of the fixed charge cap declining in real terms (the cap would have needed to increase from 30 cents to 40 cents to keep up with inflation), and changes in residential consumption resulting in an increasing majority qualifying for the low fixed charge tariff.
16. We support the Panel's proposal to abolish the Low Fixed Charge Regulations. If a transition phase is needed it should be as short as possible.
17. Given removal of the Low Fixed Charge Regulations will generally help to address energy affordability; particularly for large low income households, if there is a transition it would be best for the Regulations to be phased out rapidly. We reiterate *“The merit of a transition phase depends on a number of variables, including the impact of the next network price reset (reductions in interest rates could lower network charges) and if distribution businesses rebalance their tariffs in favour of residential consumers”*.
18. The best and simplest way to phase out the regulations would be to make no changes other than to the fixed charge cap (say over two or three years) before removing the regulations completely.
19. While there are other options, such as making changes to the thresholds, so less consumers would qualify, these kinds of alternatives would be more suited to reform of the Low Fixed Charge



Regulations rather than their removal. It would be more disruptive if there were changes in who qualifies for the low fixed charge tariff at the same time as the regulations were being phased out. (If the Low Fixed Charge Regulations were to be retained, Vocus would advocate an increase in the low fixed charge, plus lowering the threshold to reflect a genuine medium, or preferably lowering the threshold so that, say, only 25% of residential consumers would qualify for the low fixed charge tariff.<sup>10</sup>)

## Risk of impediments to reform

20. An important consideration is how to implement the reforms as rapidly and expediently as possible. It is notable a lot of the recommendations, including win-back ban, mandatory market-making and tougher wholesale market disclosure and monitoring could all be implemented by the Electricity Authority without legislative change.
21. A concern we have is, if the Panel/Government wants to rely on the Electricity Authority to introduce reform initiatives within its legislation jurisdiction, what happens if the Authority, as an independent regulator, disagrees with the reforms?
22. This isn't a hypothetical question. The concern was raised by various submitters in relation to saves and win-backs. Since the Panel released its Option Paper, the Electricity Authority has come out and made opposing statements in relation to mandatory market-making.
23. While the Electricity Authority considers that hedge market liquidity could be improved, it has not made any commitment to initiating a review or on timing:<sup>11</sup>

We have a project in our indicative 2019/20 work programme with scope to look at this issue. ... We will make a final decision on our 2019/20 work programme in June 2019.
24. Further, even though the Electricity Authority hasn't decided to undertake a review yet, the Authority has commented that the *"voluntary market making arrangements ... has ... produced significant benefits"* and the review would *"consider a number of potential improvements"* but that *"based on overseas experience"* the costs of any intervention *"may be considerable"* [emphasis added].<sup>12</sup>
25. Similarly, by way of example, while the Panel proposes *"D1: Toughen rules on disclosing wholesale market information"* and that *"The Electricity Authority would vigorously enforce the existing disclosure rules ... and ... also identify any gaps in its power to require the disclosure of further information, such as contract fuel supplies"*, the commentary in the Authority's UTS decision suggests that it considers it already has *"an effective information disclosure regime" which is a fundamental feature of a well-functioning electricity market*.<sup>13</sup>

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<sup>10</sup> The Electricity Authority's EMI website includes this kind of information which could be used for revising the Low Fixed Charge Regulations. Our submission on the first report suggested that the last round of changes to the Low Fixed Charge Regulations were based on imperfect information about residential demand. For example: "It was probably a mistake to introduce a higher, 9,000 kWh, threshold for the Lower South Region in 2009. If any change was made to the thresholds it should have been to introduce a lower threshold for warmer/lower demand areas, which was proposed at the time, but not a higher threshold for colder/higher demand regions."

<sup>11</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, page apps 3.2 to 3.4.

<sup>12</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, paragraphs 9.98 and 9.99.

<sup>13</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, paragraph 9.25 and and paragraph 9.23 onwards generally.

26. Saves and win-backs provides another example where it appears that there is a wide gap between the Panel and the Electricity Authority, at least based on MDAG commentary. While the Electricity Authority has recently floated the idea of a (limited?) regional trial, MDAG's draft recommendations paper concluded that there was no regulatory problem and a ban on win-backs wasn't justified. Notably, MDAG's "*evaluation is not concerned with direct examination or diagnosis of problems relating to market performance – such as high average prices or distributional concerns*"<sup>14</sup> and "*Customer segmentation and non-uniform pricing ... are not market failures or regulatory problems and thus not considered directly in our evaluation*".<sup>15</sup> Basically the MDAG position is that the two-tier retail market problems the Panel has identified is not a relevant consideration to the promotion of the long-term benefit of consumers.
27. If the Panel proposes to rely on the Electricity Authority it will be important to be clear about the specific nature of the proposed reforms ('the devil is in the detail'), so they aren't watered down or negatively changed, and all stakeholders are clear that legislative change will be introduced if the existing regulatory framework isn't otherwise sufficient to ensure the reforms are adopted.<sup>16</sup>

### Concluding remarks

28. There is a lot more that could be done to make the electricity sector truly competitive, and to better ensure consumers are provided efficient and affordable services. The Expert Advisory Panel proposals to promote competition are all reasonable and will unquestionably improve the level of competition in the electricity market. We welcome and appreciate the work the Panel has done, especially given the wide range of topics it was directed to cover.
29. We reiterate: "*If the Advisory Panel review is successful it will be able to deliver substantial tangible benefits to consumers. The types of measures we will be looking at are whether the size of the gap between the two-tiers in the retail market halts its increases, and starts to decline, and whether there is an improvement in the rate of change in market concentration measures, such as HHI and the market share of the 3 largest (and 5 largest) retailers*".
30. It could be useful for the Advisory Panel's report to the Minister to set out projections of the expected outcomes from its proposals. Consistent with this, the ACCC report on electricity affordability and pricing including projections of expected price reductions if its recommendations were adopted, which could be used to measure the success of the ACCC review.

Regards,

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<sup>14</sup> Market Development Advisory Group, Saves and Win-backs – Recommendations Paper, 26 February 2019, paragraph 2.6.13.

<sup>15</sup> Market Development Advisory Group, Saves and Win-backs – Recommendations Paper, 26 February 2019, paragraph 2.6.10.

<sup>16</sup> This could be done through a combination of section 18 review request by the Minister and Government Policy Statement.