

11 June 2020

Dr Brent Layton
Chair
Electricity Authority
Wellington

Dear Brent

Hedge Market development: ensuring market-making arrangements are fit-for-purpose

Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus continue to support urgent development and implementation of mandatory market-making arrangements.¹ The Authority hasn't provided details of when it expects to introduce new hedge market arrangements, but we consider the Authority can move more quickly than it currently is.

Summary of the independent retailers' views

- As the Authority is aware, **the independent retailers support mandatory market-making.**
- **We support expansion of market-making arrangements to include Trustpower/all five large incumbent vertically-integrated gentailers.**
- **If the Authority wants to achieve a fully competitive electricity market there needs to be: (i) reliable access to wholesale hedges, and (ii) hedge pricing needs to be comparable to the vertically-integrated gentailers' internal transfer prices.** The Vocus' December submission detailed the type of "Equivalence of Input" testing the Authority could undertake to determine whether market makers are using vertical-integration to impose price barriers.
- **We support continuation of "exacerbators-pay".** The need for regulation of the hedge market exists because the five large incumbents are vertically-integrated and have market power. We note the Authority's long-standing position that "exacerbators-pay" should be preferred to "beneficiaries-pay".
- The Authority appears to be more focused on the costs for market-makers of providing that service than the cost to participants that rely on market making services to buy risk mitigation products of facing low volumes, wide spreads or prices that move away from a purchaser on small volumes.
- We consider **hedge market reforms should be introduced with greater urgency** and at a greater pace than the Authority has committed to. The Authority should release a full workplan and

¹ The following letters from ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus to the Electricity Authority should be treated as part of our submission:

- Letter of Minister's expectations 2020/21: Specific expectations regarding the Electricity Price Review, 20 March 2020.
- Weakening voluntary market making arrangements is an entirely inappropriate response to COVID-19, 30 March 2020.

timeline.² We note and welcome, in contrast, that the Authority has published a target date for completion of its review of the Medically Dependent and Vulnerable Consumer Guidelines at the outset of the review.

- **The Government’s Electricity Price Review (EPR) reform decisions preclude voluntary market-making options, and they should not be considered further.**
- **The work being undertaken by market-makers on an incentive-based scheme is non-transparent, doesn’t involve independent retailers or the demand-side of the market, and would be likely to result in further delay in introduction of hedge market reform.**
- The adoption of “assessment criteria” may be useful if it helps the Authority: (i) make decisions which give effect to the purpose in section 15 of the Electricity Industry Act; and (ii) explain its decisions and provide predictability to stakeholders. **We consider that the draft assessment criteria (also referred to as “trade-offs”) need to be revised in order to aid selection of the best market-making reform option.**
- **The principal benefit from adoption of more robust, mandatory, market-making arrangements will be a stronger and more competitive retail market.** This benefit is downplayed in the Hedge Market Paper and excluded from the assessment criteria.
- Another problem with the assessment criteria is that it mixes the criteria with specific design options. For example, **the assessment criteria should** assist the Authority to determine which funding option should be adopted, and **not specify that market-making should be on a “beneficiaries-pay” basis.**
- **It appears that the Hedge Market Paper has morphed the EPR’s (supply-side) vertical-integration problem definition into a purported (demand-side) problem** that entrant retailers have low levels of understanding and experience with hedging which has resulted in “underutilis[ation of] ASX contracts for hedging purposes” and this “reduce[s] reliance on the forward price curve they produce – to the detriment of the market as a whole”.

This is an incorrect articulation of the problem and results in mis-specification of the solution e.g. that “lack of confidence” in hedging arrangements can be resolved through “education” and helping entrant retailers improve their “understanding” how to manage risk.

- We have a general concern about the Authority’s apparent perspective that new entrants have “low levels of ... experience” and lack “understanding of exchange traded futures”. It may not be **the Authority’s intention**, but the **comments appear to be critical of independent and entrant retailers’ business practices** and whether we are “act[ing] as prudent operators”. **The Authority risks its comments being interpreted as ‘victim blaming’.**
- The comments about independent and new entrant retailers contrast starkly with the Authority’s belief that it needs to preserve the “good will”³ of the “larger and more established”

² Refer to the letter from ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus to the Electricity Authority: Letter of Minister’s expectations 2020/21: Specific expectations regarding the Electricity Price Review, 20 March 2020.

³ Electricity Authority, Discussion paper, Hedge Market Enhancements (market making): Ensuring market making arrangements are fit-for-purpose over time, November 2019

market-makers, and the claim this reflects “regulatory best practice”. Statements like these could reasonably be construed as a bias towards the incumbent operators.

We support adoption of mandatory market-making, applied to all 5 of the large incumbent vertically-integrated gentailers

Key features of mandatory market-making arrangements should include:

- Extension of market-making to include Trustpower – the test should be that the potential market maker is vertically-integrated and has market power;
- No portfolio stress or opt out mechanisms – there should be no ‘days off’;
- Narrower bid offer spreads – spreads should be limited to the lower of 1% or \$0.50/MWh;
- Baseload quarterly out 3 years, baseload monthly out 6 months, and peakload quarterly contracts out 3 years;
- 3 MW on the bid and offer for all contracts with 3 reloads of 3 MW each; and
- Market makers must not buy or sell contracts for the sole purpose of lessening the availability of contracts for all other participants.

This is consistent with the EPR Panel final recommendation that “mandatory market-making obligation should include definitions of the parties on which the obligation applies, the maximum permissible spreads between prices quoted for buying and selling contracts, the contract volume obligations and the conditions that would trigger a relaxation or suspension of the obligation”.⁴ We consider that market-makers would be able to sub-contract their obligations under mandatory arrangements.

Funding of market-making should continue on an “exacerbators-pay” basis

Market-making should continue to be funded on an “exacerbators-pay” basis. This is consistent with the Government EPR direction that market-making be “funded largely by the vertically-integrated companies”.⁵

Exacerbators-pay is also consistent with the long-standing decision-making framework the Authority has adopted for various pricing matters which ranks “exacerbators-pay” ahead of “beneficiaries-pay” pricing options: “the Authority’s first preference should be to charge exacerbators and its second preference should be to charge beneficiaries”.⁶ The Authority’s “preference for exacerbators-pay” over beneficiaries-pay and use of the decision-making framework was reconfirmed in its 10 June 2020 TPM Guidelines decision.⁷

⁴ Electricity Price Review, Final Report, 21 May 2019.

⁵ Hon Dr Megan Woods, Minister of Energy and Resources, Electricity Price Review: Government Response to Final Report, 3 October 2019.

⁶ Under the Authority’s Decision-making and Economic Framework (DMEF) market-based or market-like pricing arrangements are preferred to exacerbators-pay and beneficiaries-pay but would require vertical-separation of the incumbent’s wholesale and retail businesses to successfully introduce.

⁷ Electricity Authority, Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM, Decision, 10 June 2020.

The need for intervention arises because the large incumbent generators are vertically-integrated and have market power. Contact, Genesis, Mercury, Meridian and Trustpower are the parties “whose action or inaction led to the cost in question”.⁸ As the Authority has noted intervention is needed “because New Zealand’s institutional arrangements (dominated by four large integrated generator retailers) meant that a successful exchange traded futures market was unlikely to develop without regulatory intervention”.

Despite the Authority’s preference for exacerbators-pay over beneficiaries-pay, the Hedge Market Paper treats the efficacy of beneficiaries-pay as axiomatic and embeds the method in its assessment criteria.

The option of exacerbators-pays is not even mentioned in the Hedge Market Paper. This is a material gap in the analysis that must be remedied.

The closest the Hedge Market Paper comes to mentioning exacerbators-pay is the comment that under mandatory market-making “The cost of market making would be internalised to the market makers and not visible”, and the related assertion “Understanding the costs of a scheme will lead to a more efficient outcome than one where costs are unclear or internalised to market makers”.⁹

The Hedge Market Paper referred to the Treasury guidance on cost recovery in support of a beneficiaries-pay approach, but failed to mention the Authority has previously used the Treasury guidance to support exacerbators-pay over beneficiaries-pay. The Treasury guidance includes that “exacerbators act in ways that might make it necessary for government to become involved, depending on the nature of the risk”, and an exacerbators-pay approach is suitable where a good or service has public good characteristics (which the Authority says market making does) and/or is a private good, while beneficiaries-pay is only suitable for private goods.¹⁰

Hedge market reform needs to be grounded on a solid problem definition

Our views on the problem definition align with the Wholesale Advisory Group (WAG) advice to the Authority from 5 years ago¹¹ and the EPR e.g.¹²:

Another drawback of vertical integration is that it can result in less use of contract markets – where companies buy and sell electricity ahead of time to lessen their exposure to wholesale price volatility. Vertically integrated companies have no inherent need for contract markets, whereas independent generators and retailers rely on them heavily. If large portions of the generation and retailing sectors have little use for contract markets, there will be low liquidity and muffled price signals, making it difficult and costly for independent companies to manage electricity price risks. An effective contract market, in contrast, supports ready access to contracts on reasonable terms, and sends clear price reference points for buyers and sellers.

...

An effective contract market is critical to mitigating the potential adverse effects of vertical integration and short-term generator market power. Our view is reinforced by the recent review in the United Kingdom, which concluded vertical integration was not adversely affecting competition, in part because the contract market had sufficient liquidity “for independent firms to hedge their exposure to wholesale market risk in a similar way to vertically integrated firms.”

⁸ As per the Electricity Authority’s definition of an ‘exacerbator’.

⁹ We note that the market-makers receive compensation from the ASX in the form of fee rebates.

¹⁰ Electricity Authority, Consultation Paper, Decision-making and economic framework for transmission pricing methodology review, 26 January 2012, Figure 7.

¹¹ WAG, Hedge Market Development Recommendations Paper, 26 June 2015.

¹² Electricity Price Review, First Report for discussion, 30 August 2018.

We reiterate “The incentives of the vertically integrated incumbents to discriminate in favour of their own retail businesses (limiting hedge products to external retailers, offering low related party transaction pricing from their wholesale operation to retail etc) will only get worse as the aggregate level of independent retailers’ market share gets higher, and the incumbents’ retail-generation balance separates further”.¹³

The concerns we have expressed about vertical-integration of the incumbent suppliers are orthodox, and consistent with both the EPR Panel’s views and other electricity industry regulators such as the ACCC and OFGEM.

The Authority rejects concerns about vertical-integration, seemingly out-of-hand, based on the unsubstantiated claim that “the market makers are unable to impose non-price barriers” and “are unable to impose price barriers”. This is contrary to the evidence the Authority has been provided.

Various of the submissions the Authority received in response to the previous consultation paper detailed the types of tests the Authority could undertake to determine whether current arrangements are resulting in price squeezes, including the types of analysis the ACCC has recently undertaken to assess concerns about the hedge market. If the Authority wants to adopt an evidence-based approach to decision-making it should revisit these submissions. We recommend the Authority following Vocus’ submission and undertake, by way of example, “Equivalence of Input” testing to determine whether market makers are using vertical-integration to impose price barriers.

The Authority is not undertaking its consultation from a greenfields position

We do not agree that “There is a spectrum of potential approaches the Authority can take to ensuring market making services are provided” at this stage of the hedge market development process.

The options are limited by the Government’s EPR reform decisions which directed the Authority to introduce “a mandatory market-making obligation on vertically integrated generator-retailer companies unless a better solution can be found (potentially an incentive-based scheme funded largely by the vertically-integrated companies)”.¹⁴ This, for example, precludes the status quo and other voluntary arrangements.¹⁵

¹³ Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus, Re: Discussion Paper-Hedge Market Enhancements, 2 December 2019.

¹⁴ Hon Dr Megan Woods, Minister of Energy and Resources, Electricity Price Review: Government Response to Final Report, 3 October 2019.

¹⁵ We also note we have submitted (Letter to the Electricity Authority from ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus: Weakening voluntary market making arrangements is an entirely inappropriate response to COVID-19, 30 March 2020) that the unilateral changes the Authority made in March to loosen the voluntary arrangements reinforce the need for mandatory market making arrangements:

The precedent this decision has established is that the Authority is willing to, and will make, decisions without consultation on existing market arrangements that can have a negative impact on competition and individual retailer’s operations and financial situation.

The Authority has clearly signaled that even though it already provided 5 days off per month to allow some leeway in extreme situations, when a stressed situation actually arises it will quickly allow liquidity to be withdrawn even further. It is at times like this that every business in the sector is under stress and the wholesale market remaining robust is more important than ever. For the Authority to quickly move to extend this to 7 when a stressed situation arrives totally undermines confidence in the current arrangements. The Authority decision undermines confidence in, and the integrity of, the wholesale market and related market arrangements.

The Authority’s actions serve to reinforce voluntary arrangements cannot be relied on and mandatory market making is required. It also considerably increases regulatory uncertainty.

Regardless of the direction the Government has provided the Authority, the voluntary or commercial options the Hedge Market Paper lists would not be sufficient to resolve the lack of confidence, including our lack of confidence, in the market making and price formation on the existing ASX market.

It is apparent the market-makers don't have much faith in use of current hedging arrangements

Meridian has stated that the range of financial products available is NOT sufficient to manage price risk, and the costs and risks associated with hedge market arrangements “can make them expensive risk management tools”:¹⁶

To be clear, Meridian’s position is that risk management products available in the hedge market, including those in the financial transmission rights (“FTR”), Australian Securities Exchange (“ASX”), and Over the Counter (“OTC”) markets are not always sufficient ... The ASX and FTR markets provide homogeneous baseload products that cover months or quarters at a time at set locations. The majority of nodes are not covered ... The OTC market is generally more flexible, provided that risks are forecast ahead of time and a willing counterparty can be found (something that may be challenging – for example trying to find a counterparty for a risk product to manage the risk of an export constraint out of Southland).

Mercury has stated that current hedge market arrangements mean “there is limited ability” for generators to hedge risk with financial risk management products, “and certainly not at the volumes required”.¹⁷

Genesis has also acknowledged “smaller or non-integrated parties may have greater difficulty in managing spot price risk and in buying hedge cover on acceptable terms”, but dismiss this as “a disadvantage faced by participants who choose a particular business model”.¹⁸ It isn’t obvious why Genesis consider that regulatory arrangements should favour vertical-integration, or how this would promote competition for the long-term benefit of consumers.

We do not agree with the Hedge Market Paper’s problem definition

We have the following comments and observations about the way the Hedge Market Paper depicts the ‘problem’ (or what it describes as “issues”):

- The Authority has described the “clear desire from almost all stakeholders ... to increase the reliability of market making services” as an “issue” but this is an articulation of the stakeholder views on the solution to the problem, and not the problem.
- While there is “an apparent lack of confidence among some stakeholders in market making and price formation on the ASX market” this is a symptom of the problem, rather than the actual problem.
- The claim that “A lack of confidence in the market is ultimately detrimental to consumers because it may result in participants underutilising ASX contracts and the forward price curve” ignores that the problem is a supply-side problem not a demand-side problem.
- Care is needed to avoid ‘victim blaming’. As well as suggesting one of the issues is “participants underutilising ASX contracts and the forward price curve” the Authority claims “New entrants can have relatively low levels of ... experience” and this could be resolved through “greater

¹⁶ Meridian, MDAG review of the high standard of trading conduct provisions, 4 May 2020.

¹⁷ Mercury, Discussion Paper – High Standard of Trading Conduct Provisions: A Review by the Market Development Advisory Group, 4 May 2020.

¹⁸ Genesis Energy, Re: High standard of trading conduct provisions – Discussion paper, 4 May 2020.

education to building confidence and understanding of exchange traded futures as a way of promoting risk management ...”.

It appears the Authority has morphed the EPR Panel’s (supply-side) vertical-integration problem definition into a (demand-side) problem that entrant retailers have low levels of understanding and experience with hedging, with the inference that this has resulted in their “lack of confidence”, and can be resolved through education and helping entrant retailers understand how to manage risk. It is regrettable the Authority has adopted some of the incumbent language including, for example, Genesis’ claim “the issue with some participants is a lack of understanding of the market that they, as purchasers, have elected to take risk in”.¹⁹

There are a confusing number of layers of “assessment criteria”

It can be useful to adopt an “assessment criteria”, or some form of decision-making framework, to the extent to which it helps the Authority:

- make decisions which give effect to the purpose in section 15 of the Electricity Industry Act; and
- explain its decisions and provide predictability to stakeholders.

The Authority has a plethora of different, but potentially relevant, assessment criteria/decision-making frameworks, which include:

- the draft “assessment criteria” contained in the Hedge Market Paper;
- the misnamed “Regulatory best practice” contained in Appendix A of the previous consultation paper – the status of this criteria is unclear²⁰/conflicts with the Code Amendment Principles;
- the Code Amendment Principles in the Consultation Charter – applicable to all potential Code changes; and
- the decision-making and economic framework (DMEF) the Authority has applied to various pricing related matters – directly relevant but not referred to.

The more layers there are to the assessment criteria the less useful they will be for helping the Authority make decisions or for providing predictable decision-making that can be explained by the criteria.

The Hedge Market Paper hasn’t got the “assessment criteria” right

We do not consider the Hedge Market Paper’s draft “assessment criteria” should be adopted or that the Table 1 tick-cross assessment is helpful for determining which market-making option should be adopted. There is a material risk the draft criteria would produce results that are remote from the statutory objective the Authority is trying to achieve.

¹⁹ Genesis, Improving market performance and transparency, 9 December 2019.

²⁰ The Appendix wasn’t referenced in the November 2019 consultation paper.

While the core need for hedge market reform is to remove barriers to retail competition (“promote competition”) this is absent from the criteria. The criteria are justified on the basis of reliability, confidence and efficiency, and excludes promotion of competition.

Table 1: Summary assessment of approaches against key trade-offs

Key trade-offs				
Can adjust number of market makers	Can increase diversity of market makers	Can involve markets in design of services	Can allocate costs of market making	Consequences of non-performance
<ul style="list-style-type: none"> Increases reliability Increases confidence 	<ul style="list-style-type: none"> Increases reliability Increases confidence Promotes efficiency 	<ul style="list-style-type: none"> Promotes efficiency 	<ul style="list-style-type: none"> Promotes efficiency Increases reliability 	<ul style="list-style-type: none"> Increases reliability Increases confidence

More generally, while the Authority has acknowledged the importance of the hedge market for retail and generation competition,²¹ the Hedge Market Paper downplays the importance of promoting competition. There are only six references to “competition” in the main consultation document (with four more in the Appendices). Three of these are simply references to the statutory objective, and the other three are included in a paragraph which dismisses the relevance of competition considerations. We reject entirely the position that “All things being equal, competition is promoted equally well under any of the approaches” or that competition may only “be relevant to distinguishing a voluntary approach from all the other approaches”. We are not aware of any evidential basis for these statements.

The Authority stated it “wants to increase confidence in the market for exchange traded futures products” but this also is not part of the criteria contained in the Hedge Market Paper. Another one of the problems with the assessment criteria is it mixes criteria with specific design options. The criteria includes “The allocation of the costs of market making to its beneficiaries” (“beneficiaries-pay”). It is not appropriate for the assessment criteria to pre-determine (treat as axiomatic) that beneficiaries-pay should be adopted.²² If, by way of analogy, someone decided they wanted to buy a red car the outcome of the car shopping would be predetermined. The car would be red but wouldn’t necessarily be the most reliable or efficient car available for purchase.

Elements of the Hedge Market Paper’s commentary on “assessment criteria” and “trade-offs” is relevant to assessment of the costs and benefits of different options

We agree with the Authority that there would be benefits from increasing the number of market-makers, including that it could:

- “increase both the reliability of market making”. Related to this we agree, there is “a clear desire from almost all stakeholders ... to increase the reliability of market making services”;
- “increase confidence in the market for exchange traded futures in general and in market making in particular”;
- “reduce the cost for each individual market maker to provide services”; and
- “also increase the robustness of the forward price curve, as there will likely be an increase in information held by market makers, creating a better-informed forward curve, with greater confidence in the forward price curve produced”.

²¹ For example, the Authority has noted its agreement that its TPM “proposal could increase the volatility of nodal prices, increasing wholesale market price risk for parties such as standalone retailers. That in turn could impede the entry and growth of new retailers and stymie competition” and “This underlines the importance of continuing to improve the hedge market”: Electricity Authority, Peak charges under proposed TPM guidelines, Information paper and next steps, March 2020, paragraphs 4.23 and 4.24.

²² See the discussion above on why we consider “Funding of market-making should continue on an “exacerbators-pay” basis”.

We also agree with the Authority that “The current voluntary approach has relatively weak financial penalties for non-performance” and “An explicit link between performance of market making services and an appropriate set of sanctions for non-performance [would be] an important contribution to improving confidence in the forward price curve, as well as improving the reliability of market making services as market makers will have an explicit understanding of the consequences of non-performance”.

Vertical separation of wholesale and retail is the “gold standard” and may be needed in the future

The Authority “sees vertically integrated businesses as a feature of the New Zealand market and not a problem per se” and “will not design and implement market making arrangements with the purpose of actually or effectively separating vertically integrated businesses”.

Vertical-integration is unambiguously a problem. The need for hedge market reform stems from the vertical-integration of the five large incumbent gentailers.

This is why the Government EPR reforms directed the Authority to introduce “a mandatory market-making obligation on vertically integrated generator-retailer companies unless a better solution can be found (potentially an incentive-based scheme funded largely by the vertically-integrated companies)” (emphasis added).²³

Just because vertical-integration is a feature of the New Zealand market does not make it desirable or something that should endure.

Vertical-integration of transmission and generation was originally a feature of the market, as was vertical-integration of distribution and retail. The market has been oligopolistic for the last twenty years, and market concentration is also an enduring feature of the New Zealand market.

While vertical-separation may be outside of the scope of the hedge market review, the Authority should avoid sweeping statements ruling out any or all separation options. At a minimum, the EPR reforms require the Authority to implement financial reporting of retail and wholesale.

The Authority’s statutory objective requires it to promote competition – regardless of business structure. Vertical-integration makes the Authority’s focus on this objective even more important in relation to risk management for non-vertically integrated participants.

Corporate, or more structural ownership, separation have worked successfully in both the electricity sector and telecommunications, including the relatively recent separation of Chorus’ and Spark’s wholesale and retail businesses. The experience in the United Kingdom highlights that divestment of generation assets by market-makers increases the natural liquidity in the hedge market and reduces the need for regulation or a mandatory market-maker scheme.

We agree with Trustpower about the benefits of focussing on structure and incentives and “addressing market power issues at their source via structural solutions” is the “gold standard”.

These types of options may be ‘off the table’ at this point in time but may be needed if separate financial reporting (initially applied in electricity and telecommunications) and hedge market reform, don’t eliminate market concentration and drive a fully competitive market.

²³ Hon Dr Megan Woods, Minister of Energy and Resources, Electricity Price Review: Government Response to Final Report, 3 October 2019.

Urgency is required

We consider hedge market reforms should be introduced with greater urgency and at a greater pace than the Authority has committed to. The Authority should also release a full workplan and timeline and not just the date for the next action point. The Authority has released a date (December 2020) for completion of its review of the Medically Dependent and Vulnerable Consumer Guidelines, including their replacement, and we see no reason why it couldn't do the same for the hedge market review and all other projects.

Concluding remarks

The principal benefit from adoption of more robust (which in our view requires mandatory) market making arrangements would be a stronger and more competitive retail market for the long-term benefit of consumers.

We reiterate that we agree with Trustpower about the need “to ensure that a level playing is maintained so that genuine, credible market challengers operating sustainable business models can continue to provide benefits to customers by delivering innovative solutions and competitive pricing” and “a scenario that favours the market position of the major players, that benefit already from vertically integrated ... businesses, is likely to be harmful for the competition that exists under the current market structure. If the level or structure [of the price] were such that smaller players, who are likely to act as maverick firms, were no longer able to viably compete, consumers would be worse off both in terms of reduced price competition and less innovation”.²⁴

The problems with vertical-integration have been well established by the EPR, and in reviews of the hedge market by other regulators such as the ACCC, and should not be contentious. This is reflected in our collective and individual submissions. It is also reflected by the vast majority of submitters to the EPR who supported mandatory market-making.







Ensuring market-making arrangements are “fit-for-purpose” requires hedging arrangements are available on a non-discriminatory and equivalent basis; such that market makers cannot use vertical-integration to favour their own retail businesses (e.g. lower cost access to wholesale electricity) at the expense of retail competition. The need to regulate vertically-integrated market makers is directly analogous to the requirements for utility networks to provide open or “equal”²⁵ access.

We have individually and collectively provided the Authority with evidence of this problem, and the approach the Authority could take to determine the scale of the problem and establish quantitative evidence. If the Authority wants to adopt an evidence-based approach to decision-making we consider it should revisit our previous submissions.

²⁴ See paragraphs 2.14 and 2.3.4 https://comcom.govt.nz/_data/assets/pdf_file/0033/190878/TrustpowerSubmission-on-Telco-application-of-equivalence-and-non-discrimination-obligations-18-November-2019.pdf

²⁵ Using the IPAG terminology.

Yours sincerely,

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20 March 2020

Dr Brent Layton
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cc Hon Dr Megan Woods, Minister of Energy and Resources
Gareth Wilson, Ministry of Business, Innovation & Employment

Dear Brent

Letter of Minister's expectations 2020/21: Specific expectations regarding the Electricity Price Review

As you know, Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus welcomed the Electricity Price Review (EPR) reforms. We also support the Minister of Energy and Resource's direction "that the wholesale electricity market warrants priority attention" and for the Authority to "develop its work programme to ensure [the EPR] recommendations are thoroughly considered".¹

We felt the Authority's response to the Minister's letter of expectations² was vague and light on details or commitments for when the EPR reforms will be delivered. It has been nearly 6 months since the Minister announced the EPR reforms. This should have been ample time for the Authority to at least map out project plans for each of the EPR reforms (including KPIs, project milestones and delivery dates).³

We are disappointed the Authority has only indicated "We expect to complete implementation of [seven of the major] EPR recommendations in 2020/21", and "expect to have further developed our thinking on responses to the remaining EPR recommendations" [emphasis added].

The Authority is giving itself nearly 2 years to simply further develop its thinking in relation to many of the EPR reforms, including important matters such as improving the availability of wholesale market information, requiring disclosure of information about the profitability of retailing activities and monitoring contract prices and new generation costs. We wrote to the Authority in October 2019 expressing our views about why these are high priority projects. The Authority's weak undertakings don't even require stakeholder engagement or outward progress to be met. This simply isn't good enough given the importance of the EPR reforms for delivering more affordable electricity, particularly given the current economic outlook for all New Zealanders. Consumers deserve better.

In contrast to the Authority's lack of willingness to commit to when it will complete the EPR work, the EPR Panel recommendations on timing would result in reforms being introduced within the 2020 calendar year.

¹ The wholesale electricity market is highly concentrated (based on Commerce Commission definition) and there has been a sustained worsening of the level of market concentration over the last two years.

² Electricity Authority, ANNUAL LETTER OF EXPECTATIONS FOR 20/21, 28 February 2020.

³ Stakeholders have generally been asking the Authority for project plans and delivery dates for the last several years.

From our observation, the Authority's prioritisation of its long-standing TPM review is delaying the Authority even initiating many of the EPR reforms. The Authority is currently mired down by fundamental problems with its TPM CBA, evidence the proposals will raise prices and result in increased carbon emissions, and lack of support from consumers and most other stakeholders.⁴ This work principally involves a reallocation of costs (including reallocation of HVDC charges from generators to consumers) while our priorities would make a fundamental positive difference – improving retail competition, affordability and pressure on consumer prices.

Concluding remarks

As a group, we collectively represent 8.64% of the electricity retail market, or 96.54% of the electricity retail market supplied by independent retailers.⁵ We are proudly independent entrant retailers who are responsible for delivering New Zealanders choice, innovation and keeping prices down.

The Authority should prioritise the EPR reforms and implement most, if not all, of the reforms within the current calendar year. The EPR Panel finding that consumers, particularly low income and vulnerable consumers, are paying circa \$500m p.a. too much in “loyalty taxes” highlights the benefit of fast-tracked implementation of the EPR reforms.

The Authority should commit, including as part of its response to the Minister's letter of expectations, to specific project plans and implementation timeframes for each of the EPR projects to ensure they are delivered in a timely manner.⁶

We are also frustrated it has been nearly 6 months since the Minister announced the EPR reforms and the Authority has not updated its workplan to include the EPR reform projects that weren't already in the plan.⁷ The consultation calendar hasn't been updated since early December 2019 despite the Authority Board meeting (e.g. 18 December) to discuss how it will prioritise and reshape its work programme to incorporate the Government's EPR decisions and expectations.

The Authority's committed to “deliver ... projects faster, so that the benefits for consumers are realised sooner” and to “set ... more ambitious targets for our top priority projects” in 2018 but we have seen little or no sign of this happening.⁸

We are willing and able to assist the Authority progressing the Minister's priorities at pace and would welcome the opportunity to discuss our perspectives with the Authority Board again in the near future.

⁴ In response to the Authority 2020/21 Appropriations consultation, we expressed concern about the indications the Authority will be undertaking a substantial amount of work and consultation on the TPM and the TPM CBA over the next 6-months (potentially longer) and the TPM review will continue to be a distraction from more important priorities.

⁵ By contrast, ERANZ represents 100% of the incumbent retailers and one independent retailer supplying 1,336 ICPs (0.06%) of the retail market (data from ERNAZ' website on 19 November 2019).

⁶ We have specific suggestions about how to scope some of this work – in particular, the retailer profitability project. Our approach includes an intermediate step that is easy to progress and has the potential to make a real difference to competition for the long-term benefit of consumers. This work does not have to be complicated or require years of deliberation and consultation. We are scheduled to discuss our recommended approach with staff at their convenience.

⁷ As per, Electricity Authority, Updated Electricity Authority Work Programme 1 July 2019 - 30 June 20 20, 4 February 2020.

⁸ <https://www.ea.govt.nz/dmsdocument/23836-market-brief-24-july-2018%23mctoc1#mctoc1>

Yours sincerely,

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30 March 2020

Dr Brent Layton
Chair
Electricity Authority
Wellington

cc Gareth Wilson, Ministry of Business, Innovation & Employment

Dear Brent

Weakening voluntary market making arrangements is an entirely inappropriate response to COVID-19

Ecotricity, Electric Kiwi, energyclubnz, Flick Electric, Pulse and Vocus recognise the substantial impact COVID-19 is and will have on Kiwi households and the economy, and that the essential nature of electricity means consumers need surety the 'lights will stay on'.

This is having a marked impact on the priorities and focus within the electricity sector, with a heightened need to focus on what is best for consumers. We are observing this shift in focus with electricity industry regulators in other jurisdictions addressing issues to do with disconnection, payment arrangements and the financial hardship many electricity consumers are facing in this difficult time.

We were surprised and deeply disappointed the first substantive action the Electricity Authority has taken in response to COVID-19 was too soften the voluntary market making requirements. There are a number of matters the Authority should be focussing on right now in light of the COVID-19. This is not one of them.

There is no reasonable basis on which COVID-19 would impact market making

We do not accept the Authority's assertion "changes are a reasonable and pragmatic way [the Authority] can ensure market making services continue to be provided and that risk management tools are available through the current Covid-19 emergency".¹ This claim was used to justify the changes but has not been explained or substantiated. We would appreciate explanation of the basis on which this conclusion was reached and the decision was made.

It may be that part of the reason the Authority has been willing to loosen the already weak market marking provisions is based on the misconception the provisions include "very tight performance criteria" which are made "especially difficult in remote environments".² We reject both of these propositions.

There was and is no legitimate or reasonable reason or need for a loosening of market market arrangements due to COVID-19.

All market participants in the electricity industry should have comprehensive contingency plans for continuing to operate in situations like this. Market making is among the simplest market functions

¹ E-mail from Andy Doube (Electricity Authority), Subject: NZ Electricity Market Making, 27 March 2020 at 3:29 PM.

² E-mail from Andy Doube (Electricity Authority), Subject: NZ Electricity Market Making, 27 March 2020 at 3:29 PM.

to provide from a remote location being provided by small teams and being a purely electronic transaction service. The same people that do market making are managing to dispatch generation.

The Authority adopted a non-transparent process for making its decision which favours incumbent market makers at the expense of consumers and the rest of the market

As a matter of even the most minimal notion of good regulatory practice, the Authority should have engaged and consulted with all affected parties before making a decision to weaken the voluntary market making arrangements.

We presume the Authority did not make its decision unilaterally, and the decision followed/was driven by liaison with the market makers.³

The engagement with market markers and other affected parties should have been, and needs to be, symmetric, equal and transparent.

The unilateral changes reinforce the need for mandatory market making arrangements

We see this is nothing more than a cynical and opportunistic move on the incumbents' part to curtail retail competition by withdrawing liquidity.

The precedent this decision has established is that the Authority is willing to, and will make, decisions without consultation on existing market arrangements that can have a negative impact on competition and individual retailer's operations and financial situation.

The Authority has clearly signaled that even though it already provided 5 days off per month to allow some leeway in extreme situations, when a stressed situation actually arises it will quickly allow liquidity to be withdrawn even further. It is at times like this that every business in the sector is under stress and the wholesale market remaining robust is more important than ever. For the Authority to quickly move to extend this to 7 when a stressed situation arrives totally undermines confidence in the current arrangements. The Authority decision undermines confidence in, and the integrity of, the wholesale market and related market arrangements.

The Authority's actions serve to reinforce voluntary arrangements cannot be relied on and mandatory market making is required. It also considerably increases regulatory uncertainty.

Concluding remarks

COVID-19 will put independent retailers and many other businesses under considerable financial pressure.

It is inevitable there will be substantial increases in non-payment and customer debt. We are seeing this already. We do not have the benefit of a wholesale business to fall back on (we are not aware of any Electricity Authority initiative to extend market settlement times to help relieve the financial pressures retailers will face during COVID-19) or the circa \$500m p.a. of 'loyalty taxes' from an incumbent retail base (customers who don't switch) to fall back on.

The weakening of the voluntary market making arrangements will simply add to the financial duress we are now under, and add to the challenges we will face during COVID-19.

We are open to work directly with the Electricity Authority, Government and other market participants and stakeholders to work through how to best manage COVID-19 and how to best look after vulnerable consumers and consumers facing hardship during this difficult time.

³ This is a matter we will be seeking clarity on by way of Official Information Act request.

Yours sincerely,

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