14 December 2022

Sarah Gillies
Acting Chief Executive
Electricity Authority
Wellington

By e-mail: reviewconsultation2022@ea.govt.nz, mdag@ea.govt.nz

Dear Sarah,

The Authority has robustly identified large, structural problems in the wholesale electricity market

2degrees, Electric Kiwi, Flick Electric, Haast Energy Trading (Haast) and Pulse (the independents) are very supportive of the Authority's sound work identifying problems in the wholesale market but are disappointed with some key aspects of the latest consultation.

The Authority signalled, just 2-months prior to this consultation, that "structural options may be considered as part of the wider wholesale market competition review"[1] but now says it would be "inappropriate and premature for it to put forward specific structural proposals at this point".

It looks like the Authority could end up making the same mistake as the Commerce Commission in the retail grocery inquiry. The Commerce Commission robustly identified large competition problems but only proposed actions which would help around the edges. The Government had to step in and develop a new wholesale access and regulatory regime itself.[2]

While the Authority has presented a long-list of "reforms" the proposals amount to a modified status quo and retaining "The presence of market power" that comes with it. Regulatory incrementalism won't resolve fundamental structural problems or deliver a high performing and efficient and competitive market for the long-term benefit of consumers. The Authority's proposals would leave substantial risk of unintended consequences, including harm to the interests of consumers, electricity affordability and the Government's climate change/electrification ambitions.

If the suite of changes do not adequately resolve the major competition problems or market failures they could result in short-term regulatory stability but medium to longer-term regulatory uncertainty. We agree with MDAG that:[3]

> A lack of confidence in competition is obviously a problem for consumers, but it can also be bad for suppliers. If policy makers lack confidence in competition, the policy/regulatory environment will be less stable. That in turn can have a chilling effect on the longer-term investments needed to underpin the shift to renewables.

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[1] Electricity Authority, Inefficient Price Discrimination in very large electricity contracts, Proposed Code Amendment Consultation Paper, 18 August 2022.
[2] e.g. https://legislation.govt.nz/bill/government/2022/0191/latest/LMS743553.html?search=ts_act%40bill%40regulation%40deemedreg_Grocery_resel_25_a&p=1
[3] MDAG, Price discovery in a renewables-based electricity system, OPTIONS PAPER, 2 December 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/MDAG-options-paper-final-2.pdf.

The perseverance of major problems sends a message current market and regulatory settings are not sustainable and substantive change will be needed in the future. We agree with MBIE that:[4]

> ... the electricity sector in New Zealand will need to adapt rapidly if it is going to maintain its social license to operate. If people lose trust in the market and market participants, perhaps because of pricing or reliability, then the political process may explore alternatives to the current market. Such alternatives exist and are being used in other jurisdictions.

We have seen this in telecommunications in the 2000s when the Government got fed-up and stepped in. The Telecommunications Act was introduced in 1999 and, following the conservative approach adopted by the Commerce Commission, was ultimately overhauled in 2005, including by reversing previous Commerce Commission recommendations against regulation of Local Loop Unbundling (LLU). The Prime Minister's recent comments about banking super-profits could just as easily have been aimed at the gentailers.[5]

Summary of the independents' views on the WMR2

- The independents consider that **the Authority has robustly identified large, structural problems** in the wholesale electricity market.

- The Authority has produced a wide range of evidence, in both the 2021 and 2022 WMR consultation material, which all confirm: (i) the wholesale market is concentrated; (ii) the large, incumbent generators have significant/substantial market power; (iii) competition isn't as strong as it should be; (iv) supply is being constrained; and (v) prices have been significantly above costs by too much and for too long. This analysis is complemented by MDAG which found market power issues could worsen as New Zealand moves to greater reliance on renewable energy.

- The Authority's initial, 2021, findings were largely confirmed and supported by stakeholders.[6] The Authority robustly responded to the limited criticisms (principally Meridian) in its 2022 consultation material. The criticisms were high on rhetoric and asserted the electricity market is highly competitive without any valid proof or evidence.

- Based on the evidence the Authority has produced, it is unclear how the Authority reached the conclusion that "Taken together, the suite of structure, conduct and performance indicators did not allow the Authority to reach a conclusive view". **The scale of the problem the Authority has identified means it isn't "ambiguous whether the current market is consistently delivering our expectations of competitive outcomes".** The 12-months taken for the 2nd stage of the WMR should have enabled the Authority to back the good work it and its staff have done and firm up its views about the problems in the electricity market.

- **If there is any uncertainty about the problems the Authority has identified it is how large is large, not whether there is a problem.**

- We note the Authority was similarly cautious about making a firm determination that the Tiwai arrangements were discriminatory and inefficient and, as a consequence, it received submissions from the incumbent gentailers which used this to claim there isn't a problem.

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[4] MBIE, Investigation into electricity supply interruptions of 9 August 2021, 2021: https://www.mbie.govt.nz/dmsdocument/17988-investigation-into-electricity-supply-interruptions-of-9-august-2021

[5] https://www.1news.co.nz/2022/11/08/pm-asks-banks-to-reassess-record-profit-making/

[6] Including the Authority's UMR survey of market participant perceptions.

- The policy prescription in the 2022 consultation places too much faith on: (i) behavioural regulation (trading conduct rules); (ii) new entrants reducing the market share of the large, incumbent generators; and (iii) the work of other agencies such as MfE and MBIE. While the amount of new generation that is forecast to be needed presents an opportunity to reduce market concentration this would be contrary to the experience over the last decade+.

- **The large, structural problems the Authority has identified aren't going to go away based on the Authority's proposals.** There is a very real and substantial risk of unintended consequences if a reform package is recommended and adopted which is not proportional to, and does not adequately address, the problems MDAG and the Authority have identified in the wholesale market and in the transition to greater reliance on renewables.

- Ultimately, **if the underlying competition issues are not adequately addressed there will be an increasing need to rely on regulatory interventions.** The more market power there is in the wholesale market, for example, the greater the need for regulation of hedge market arrangements, including mandatory market-making for products such as capped products.

- We reiterate "**We urge the Authority to focus on options which address the underlying problem and not just the symptoms**". None of the options the Authority has put on the table would address the large, structural problems in the market. As an independent agency the Authority should have the conviction to back the work it has done and develop policy reform proposals, without fear or favour, which are proportionate to, and will address, the problems it identified.

- The 2022 consultation has only provided generalised commentary about possible negative impacts of structural reform and has not assessed, either qualitatively or quantitatively, the potential competitive benefits.[7] It is "inappropriate" to reject an option without considering both the costs and benefits.

The Authority has robustly identified large, structural problems

The Authority's initial findings were largely confirmed and supported by stakeholders.[8]

The Authority should not be concerned by strongly protectionist, incumbent submissions. The Authority could have forecast what the incumbents would say simply by reading the submissions of their supermarket brethren in response to the Commerce Commission retail grocery inquiry.[9]

The criticisms were high on rhetoric and lacked any genuine merit.

[7] The Authority has not referenced or substantiated its claim that: "The literature indicates it is unclear if going from a small number of competitors to a somewhat larger, but still small, number would improve competition. It might, but it might not." This is certainly not our experience based, for example, on entry of 2degrees in the cellular market.
[8] Including the Authority's UMR survey of market participant perceptions.
[9] The incumbent supermarket and incumbent gentailer submissions are clone submissions, using many of the same consultants, asserting the market is highly competitive, the regulator has overstated excess pricing, and the regulator's analysis is flawed and inadequate e.g.:

- Foodstuffs North Island: "Retail competition is characterised by strong and dynamic constraints".
- Foodstuffs South Island: "Competition is working well as the major grocery retailers and other retailers compete vigorously on price, quality and service."
- Foodstuffs South Island: "FSSI's view is that the wholesale supply of groceries in New Zealand is functioning well."
- Woolworths NZ: "Grocery prices in New Zealand do not suggest that there is an issue with competition".

We do not agree with Meridian's assertions and criticisms of the Authority's analysis, for example, that "The Authority's analysis … is flawed and makes several incorrect assumptions", "is based on untestable assumptions", "The Authority has made no attempt to understand the impact of gas market uncertainty on hydro storage management and security of supply" or that the peer reviews show "there is no evidence market power has been exercised".

The Authority robustly responded to the criticisms (principally Meridian) in its 2022 consultation material.

There was nothing in the Meridian or other submissions that should give the Authority concern about the good work it and its staff have undertaken. The Authority also correctly noted elements of Meridian's submissions (e.g. Axiom and Hansen) undermined their claims that there isn't a problem and highlight the exercise of market power including by "contrived scarcity".[10]

The 2022 consultation material confirms "Spot and forward prices have remained above price levels that prevailed before the period covered by the WMR". There is nothing to suggest the $38/MWh of unexplained over-pricing has gone away.

Evidence such as $38/MWh of unexplained over-pricing and the Tiwai contracts resulting in spot prices $863m higher per annum than they should be indicates there are very, very substantial problems. If there is uncertainty it is about how large is large. Even if the Authority modelling estimates overstated the problem (it may well be that it understates it) there would still be very, very substantial problems.

Consistent with the MDAG renewables work, 2022 consultation confirms "The transition toward 100% renewable electricity may increase market power of generators with storable fuel" and market concentration issues could remain at their current levels (HHI = 2000) or get worse (with Concept Consulting detailing scenarios where HHI could rise above 2,300 by 2030). MDAG has also shown that the HHI measured in terms of ownership of flexible hydro and thermal capacity is currently a very high 2,482 and could deteriorate to 2,617 by 2035.[11] In our 2021 joint submission to MDAG on 100%RE, we explained why we consider it most likely market concentration will worsen from an already bad state. The large amount of additional generation that will be needed creates both a risk and an opportunity for competition depending on who undertakes the investment.

The sustained exercise of substantial market power elevating spot prices that the Authority identified in the initial WMR consultation hasn't gone away

The Authority's post-implementation review (PIR) of the new trading conduct rules was conducted in too brief a period (less than a year) to be useful. The PIR conclusion that "The new trading conduct rule appears to be effective" simply highlights the Authority has not identified short-term or transitory abuses of market power. This does not change the clear evidence of substantial and sustained exercise of market power and elevated spot prices.

It is important to recognise the new trading conduct rules are focussed purely on efficiency. They do not prohibit a supplier from charging high (above economic cost) prices or harming consumers per se.

The Authority also details at length why it is hard to identify/uncover market power and or trading conduct breaches, which reinforces that "the only impact of the new rule may be to temper extreme

[10] The Electric Kiwi and Haast submission to MDAG on 100RE made similar observation.
[11] Concept Consulting and John Culy, 100% renewables electricity supply – competition issues, 24 August 2022.

behaviour". The Authority's clear statement that December 2019 wasn't a trading conduct breach because of loopholes in the rules at the time may well have had a bigger impact on behaviour than the rule change itself.

Notably, the Authority has observed spot prices have remained elevated.

It is unclear on what basis the Authority considers that the PIR found "offer prices more closely reflect underlying conditions and economic costs compared to past years". In order to substantiate this claim, the Authority would need to extend its regression analysis to test the extent to which the elevated prices since June 2021 may be explained by supply and demand conditions or exercise of significant/substantial market power.

The Authority has made statements contradicting its WMR findings

We have not been able to reconcile the Authority's statements that there is "evidence to suggest that prices may not have been determined in a competitive environment" (2021 WMR) and there has been a "persistence of high spot and forward prices, well above the cost of new renewable supply" (2022 WMR) with the unqualified claim that "outcomes in the spot and hedge markets are consistent with a healthy and efficient market to the long-term benefit of consumers" (May 2022).[12]

The Authority's view that "a market is dynamically efficient in a workable competition sense if it tends towards an efficient equilibrium over time"[13] makes clear the WMR findings do not support the claim that "outcomes in the spot and hedge markets are consistent with a healthy and efficient market".

Structural reform is the best option for promoting competition and transition to 100% renewable electricity

Structural reform is the only option on the table that would directly address the underlying problem that the market is highly concentrated/the large, incumbent generators have substantial/significant market power.

We agree with Prof. Paul Joskow: "Market power is a significant potential problem in electricity markets, but the cure can be worse than the disease. Try to deal with potential market power structurally ex ante rather than ex post"[14] and Prof. Stephen Littlechild that, given the difficulties of satisfactorily defining and proving anti-competitive conduct, it is better to focus on structure and incentives in designing remedies (new entry, enforced divestment, contracts markets and the like), rather than on conduct.[15]

We also agree with the Authority it is not "appropriate to always rely on the current incentives of incumbent firms to do what is best for wider society" and "Market design and structure may require change to ensure commercial incentives promote the efficient operation of the electricity industry for the long-term benefit of consumers".[16]

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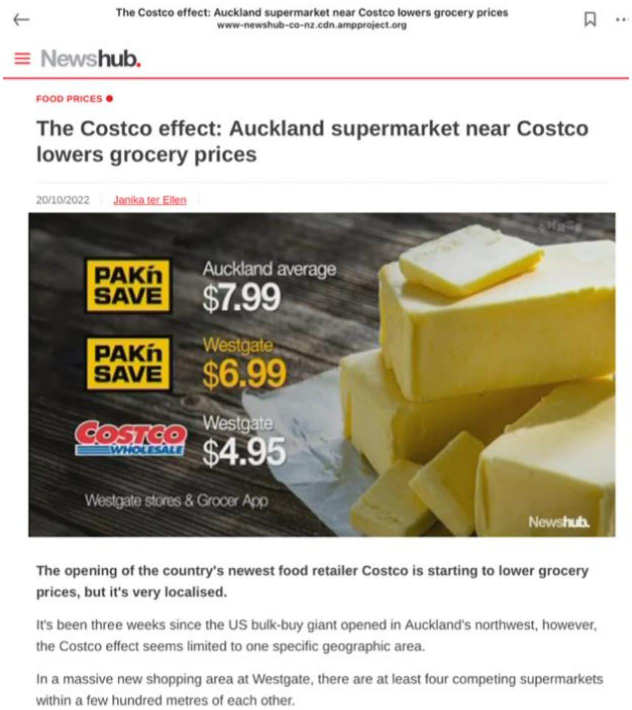
[12] Electricity Authority, Re: Flick Electric submission to the Petitions Committee on market pricing and vertical-integration in the electricity market, 27 May 2022.
[13] https://www.ea.govt.nz/assets/dms-assets/23/230442June16HighPrices.pdf
[14] Joskow, 2007, Lessons Learned from Electricity Market Liberalization, page 12 - http://econwww.mit.edu/files/2093 cited in Investigation Report: Commerce Act – Electricity Investigation", Commerce Commission 21 May 2009 at 665.
[15] As cited in MDAG, Price discovery in a renewables-based electricity system, OPTIONS PAPER, 2 December 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/MDAG-options-paper-final-2.pdf.
[16] Electricity Authority, Inefficient Price Discrimination in very large electricity contracts, Proposed Code Amendment Consultation Paper, 18 August 2022.

It is unclear why the Authority now considers it "inappropriate and premature for it to put forward specific structural proposals at this point". The Authority signalled in its inefficient price discrimination consultation 2-months prior that "structural options may be considered as part of the wider wholesale market competition review".

The Authority has not referenced or substantiated its claim that: "The literature indicates it is unclear if going from a small number of competitors to a somewhat larger, but still small, number would improve competition. It might, but it might not". This is certainly not our experience based, for example, on entry of 2degrees in the cellular market. The Commerce Commission has commented:[17]

> Competition is a significant driver of economic progress … As an example of the tangible benefits that competition can bring to a market, it is estimated that increased competition in mobile related markets from 2Degrees Mobile's entry was worth at least $10.1 billion to the New Zealand economy for the period from 2007 to 2021 (this figure excludes intangible benefits).

Media coverage also highlights that it is not the experience based on entry of Costco in West Auckland e.g.:


The Costco effect: Auckland supermarket near Costco lowers grocery prices
www-newshub-co-nz.cdn.ampproject.org

Newshub.

FOOD PRICES

The Costco effect: Auckland supermarket near Costco lowers grocery prices

20/10/2022 | Janika ter Ellen

The opening of the country's newest food retailer Costco is starting to lower grocery prices, but it's very localised.

It's been three weeks since the US bulk-buy giant opened in Auckland's northwest, however, the Costco effect seems limited to one specific geographic area.

In a massive new shopping area at Westgate, there are at least four competing supermarkets within a few hundred metres of each other.

The 2022 WMR consultation has only provided generalised commentary about possible negative impacts of structural reform which could have just as easily been used against separation of ECNZ and Transpower, and the establishment of the baby ECNZs. The Authority has not assessed, either qualitatively or quantitatively, the potential competitive benefits of structural reform.[18] It is "inappropriate" to reject an option without considering both the costs and benefits.

In contrast to the Authority views, MDAG have commented that "If structural solutions are ultimately required, they should be put in place with the least possible delay. That means some initial scoping work would make sense as a precautionary step, even if it turns out structural options

[17] https://www.parliament.nz/resource/en-NZ/53SCED_EVI_108304_ED566/3fa25be9532af1f15a750208f704ae50ec31deab

[19] MDAG, Price discovery in a renewables-based electricity system, OPTIONS PAPER, 2 December 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/MDAG-options-paper-final-2.pdf.

were not ultimately needed." [emphasis added][19] MDAG also explore virtual options which might be worth considering.

Ultimately, we agree with Manawa Energy (nee Trustpower) that structural reform is the "gold-standard".[20] If structural reform is not considered viable, for political or other reasons, then a higher degree of industry regulation, including wholesale input access, non-discrimination and equivalence of inputs rules, arms-length dealing rules etc, will be needed to curb market power and ensure competition can develop and thrive.

"The presence of market power is, and will continue to be, a reality in the New Zealand wholesale electricity market" under the Authority's favoured options

The options the Authority has presented can be grouped into three categories:

- options which rely on behavioural regulation/will not reduce market power/market concentration e.g. regulation of very large, discriminatory contracts;

- options which will improve competition around the fringes e.g. promotion of DER; and

- options which, at best, might reduce market power/improve competition over the very long-term e.g. reform of RMA.

There is nothing in the Authority proposals that would influence delivery of more new generation capacity that is needed by 2025 (as identified in Concept's report) or impact on the large, incumbent generators' decisions and incentives about the timing of new generation investment.

The Authority's package of proposals relies heavily on other agencies and Government so it is not clear how much of it will be adopted or whether even the modest benefits from the Authority proposals will be realised.

Essentially, while the Authority has presented a long-list of "reforms", its proposals amount to retaining the status quo and "The presence of market power" that comes with it.

Competition in the retail market remains severely stressed

The independents continue to ask the Authority to consider how the wholesale market interacts with the retail market, and how the wholesale issues it has identified have spilled over into electricity retail. The narrow wholesale-only focus of the review provides an incomplete picture of the size of the problem and its negative impact on the electricity industry.

We reiterate that the European Union recognises "Where [a supplier] has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the [supplier]". In short, what this says is that problems of market power in the wholesale electricity market can result in heightened market power problems in the retail market. This is consistent with our observations and experience.

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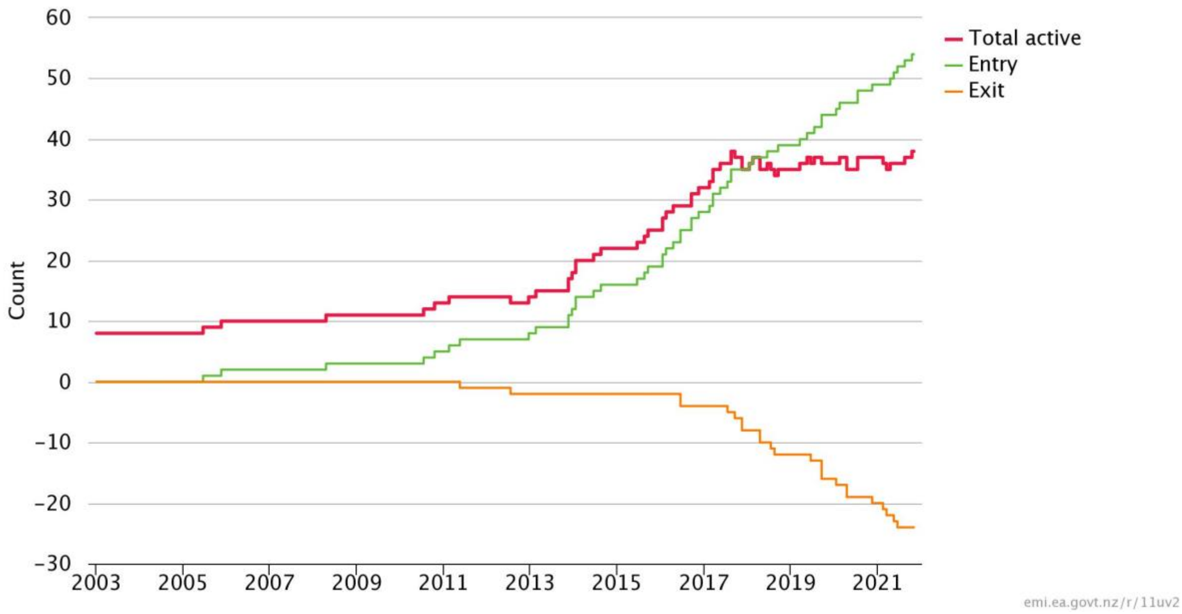
[19] MDAG, Price discovery in a renewables-based electricity system, OPTIONS PAPER, 2 December 2022, available at: https://www.ea.govt.nz/assets/dms-assets/31/MDAG-options-paper-final-2.pdf.
[20] https://www.ea.govt.nz/assets/dms-assets/26/26736Trustpower-Submission-MDAG-HSOTC-discussion-paper.pdf.

It is reasonable conclude, for example, that if 1. wholesale market prices have risen for a sustained period of time and are $38/MWh higher than they should be or can be explained by supply and demand conditions, and 2. the unprecedented increases in wholesale prices have not yet translated, or fully translated, into higher retail prices, then the margins and profitability of independent retailers – and their ability to compete on price – will be severely hampered. This, at minimum, provides prima facie basis for concerns that there is a price squeeze issue and about the health of competition in the retail market and justification for investigation.

Independent retailer growth has slowed or stalled at times during record high wholesale prices. It is notable, also, that only 5 electricity retailers had exited the market prior to August 2018 and this number has since grown to 25. (The number of retailers that have exited excludes examples such as ecotricity that were instead bought out by an incumbent.)[21]



The Authority's 2021 UMR survey highlighted only 19% of all market participants agree there is a level playing field for independent retailers, and this result is skewed upwards by the gentailers. When the gentailer views are excluded, the result dropped to just 9% of market participants agreeing there is a level playing field.[22]

None of this should come as a surprise given the differential between wholesale and retail prices is resulting in price squeezes for independent retailers. The incumbent gentailers can offset loss of retail margins through increased wholesale margins (cross-subsidisation). Independent retailers cannot. There is no level playing field. The independent retailers haven't taken actions like withdrawing from Powerswitch, limiting customer growth or putting a pause on new customers lightly or absent very severe problems in the market. The Authority now has gross margin reporting from retailers with >1% market share but hasn't published it or any analysis of the results.

[21] https://www.emi.ea.govt.nz/Retail/Reports/3CL0V1?_rsdr=ALL&seriesFilter=T,I,X&_si=tg|market-structure,v|3

[22] The Authority has released limited information from its 2022 survey results which indicates a slight improvement in market participant perceptions about whether new entrant retailers can operate on a level of playing field, but the Authority has not included a breakdown of market participants that participated in the survey so it is not clear whether this reflects a genuine change in perceptions or a change in the make-up of the survey participants e.g. increased percentage of responses from gentailers.

We welcome the Consumer Advocacy Council's comments that:[23]

General comments

3.5. We were disappointed with the EAs response noted in paragraph 4.13

> *Some submitters, most notably independent retailers, claimed that Over the Counter (OTC) hedges (or off-exchange trading) were either unavailable to them or more costly than can be justified. However, the submitters did not provide sufficient new evidence in support of these claims to justify expanding the scope of this investigation to include OTC contracting between generator-retailers and independent retailers. However, the efficiency of OTC markets will continue to be monitored as part of the Authority's on-going hedge market development programme.*

3.6. The availability of hedges to new entrants and smaller retailers appears to have had an impact since late 2018. Since 31 October 2018, 15 retailers have left the electricity market[1] and another five have remained at minimum customer numbers. While there may be valid reasons for such a large turnover, we understand that wholesale pricing and lack of competitive hedging arrangements is one of those reasons.

3.7. The Electricity Market Information (EMI) shows prices increasing significantly and remaining high. The long dated forward price curve increased from about $80/MWh to close to the current $170/MWH.[2] We agree with the independent retailers that there is a possibility of a form of price discrimination in the market.

3.8. Any price discrimination that may exist in availability and prices of hedges may directly impact consumers by removing or limiting competition from the electricity market. This may remove consumer choice and in the long term could remove downward pressure on electricity prices.

Recommendation:
The Council recommends that the EA reconsider investigating the over the counter contracting between generator-retailers and independent retailers.

The success of incumbent and independent retailers should hinge on who can 'out-compete' their competitors through superior innovation, better products, lower prices and/or efficiency. This will only happen if there is workable competition and "To that end there must be an opportunity for each participant or new entrant to achieve an equal footing with the efficient participants in the market by having equivalent access to the means of entry, sources of supply".[24]

Evidence the retail market suffers from competition problems and is concentrated or highly concentrated is provided in the Appendix to this submission. Much of the evidence we use mirrors evidence the Authority used in at attempt to claim the opposite in its advice to the Petitions Committee.[25] Contrary to the Authority's claim "There is clear evidence of thriving competition in the retail market" the evidence the Authority relied on showed the market is concentrated. It is unclear why the Authority thinks, for example, statistics which show retail market HHIs mostly exceed 2,000, with some exceeding 3,000, supports the claim there is "thriving competition".

The ACCC is looking at similar issues in the Australian National Electricity Market

We consider that the ACCC inquiry into electricity supply in Australia[26] has useful parallels to the WMR and the MDAG 100RE project which should be taken into consideration. The ACCC inquiry includes detailed consideration of the impact of recent electricity market conditions and settings on electricity retailers and retail competition.

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[23] Consumer Advocacy Council, Re: Propose Code Amendment - Inefficient Price Discrimination in very large electricity contracts, 31 October 2022.
[24] Bruce G Donald and JD Heydon Trade Practices Law: Restrictive Trade Practices, Deceptive Conduct and Consumer Protection (Law Book Co, Sydney, 1978) as cited in Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd [1987] 2 NZLR 647 (HC) at 671; and Fisher & Paykel Ltd v Commerce Commission [1990] 2 NZLR 731 (HC) at 757-758.
[25] Electricity Authority, Re: Flick Electric submission to the Petitions Committee on market pricing and vertical-integration in the electricity market, 27 May 2022.
[26] ACCC, Inquiry into the National Electricity Market, November 2022, available at: https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20-%20November%202022%20report.pdf.

The ACCC, for example, have commented:

- “Maintaining and developing competition in electricity markets throughout the transition to renewable energy is of paramount importance. Well-functioning competitive markets are critical to delivering the investment needed for new electricity generation and storage capacity at an efficient cost to consumers.”

- “…as the sector transitions and the existing generation portfolio is largely replaced by new generation and storage, there is an opportunity to achieve a greater level of competition in the market through the diversification of generation types and ownership. There is also the risk that, without careful action by governments, the transition sees existing generation ownership trends retained or worsened”.

- “To maintain and promote competition during periods of temporary price volatility, it is essential that market participants can appropriately manage financial risks. Our analysis indicates that retailers are finding it increasingly difficult to manage their exposure to prices in a volatile spot market. This, in turn, increases the likelihood of retailer failure, declining competition, and higher bills for consumers.

  “Preserving competition in retail markets is the best way to deliver benefits to households and businesses over the longer term. … it is … crucial to preserve the conditions for future retail competition.”

- “Managing risk is increasingly challenging

  “Access to exchange-traded and over-the-counter hedging contracts is critical to allow electricity retailers and generators to manage their exposure to price and volume risk.”

- “High and volatile wholesale electricity spot prices, coupled with high contract prices, reduced access to hedging contracts, … are impacting the financial viability of retailers.”

- “A liquid contracts market underlines a competitive wholesale electricity market”

- “Hedging contracts are essential to managing risk for market participants”

- “Recent and current market conditions are having a significant impact on the ability of retailers to manage their risk.”

Concluding remarks

The Authority has a clear choice between “regulatory stability” and addressing the underlying large, structural problems in the market. This represents an important cross-road for the Authority if it wants to build “trust and confidence” and “thriving competition”. We have not seen any evidence to suggest addressing market failures and promoting competition would undermine business certainty in a way that would result in New Zealand being worse off.

The independents consider the Authority should:

- consider what it needs to do to reach the level of confidence the Commerce Commission had about the extent of competition problems in the retail petrol and grocery studies;

- apply the regression analysis it undertook as part of WMR1 over a period up until and including 2022 to test the extent to which prices remain high for reasons other than underlying supply and demand conditions;

- model the impact of different reform options, including structural reforms, on competition and spot prices (mirroring the work the Officials' Committee on Energy Policy undertook as part of the break-up of ECNZ). The Authority should be very clear about the extent to which different options would be expected mitigate or address the problems it has identified; and

- extend the review to include retail market impacts, including (i) the interrelationship between a well functioning hedge market and spot prices; and (ii) equal opportunity for independent retailers to access hedging arrangements, including mass market shaped hedging, that enable competition on a level playing field. It is important to ensure that incumbent access provider/gentailer pricing would satisfy price squeeze/equivalence of input tests.

Yours sincerely,

Emma-Kate Greer GM Corporate Affairs and Strategy Emma-Kate.Greer@2degrees.nz	Luke Blincoe Chief Executive luke.blincoe@electrickiwi.co.nz	Pavan Vyas Chief Executive pavan.vyas@flickelectric.co.nz
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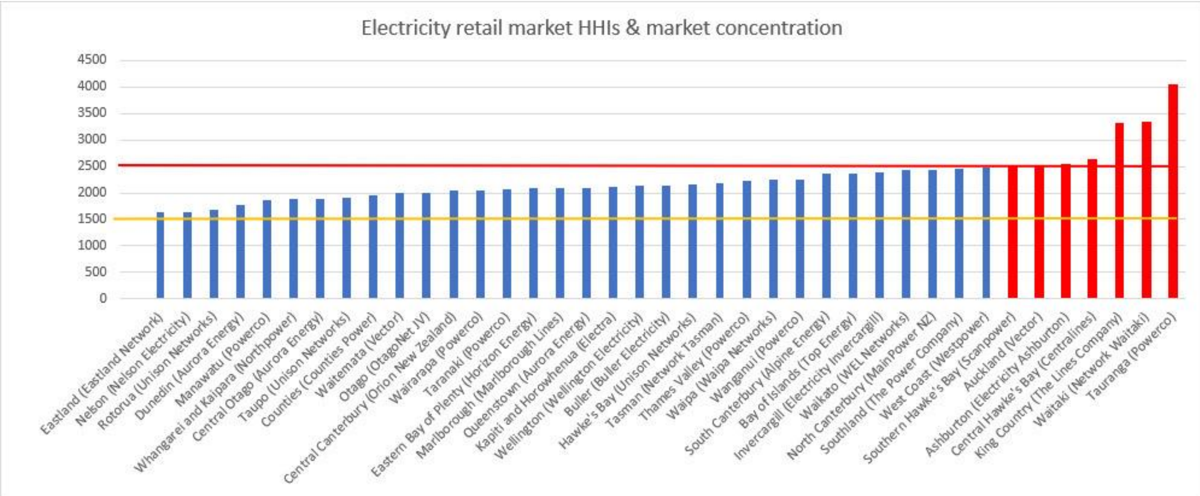
Appendix: Evidence that the electricity retail market is concentrated

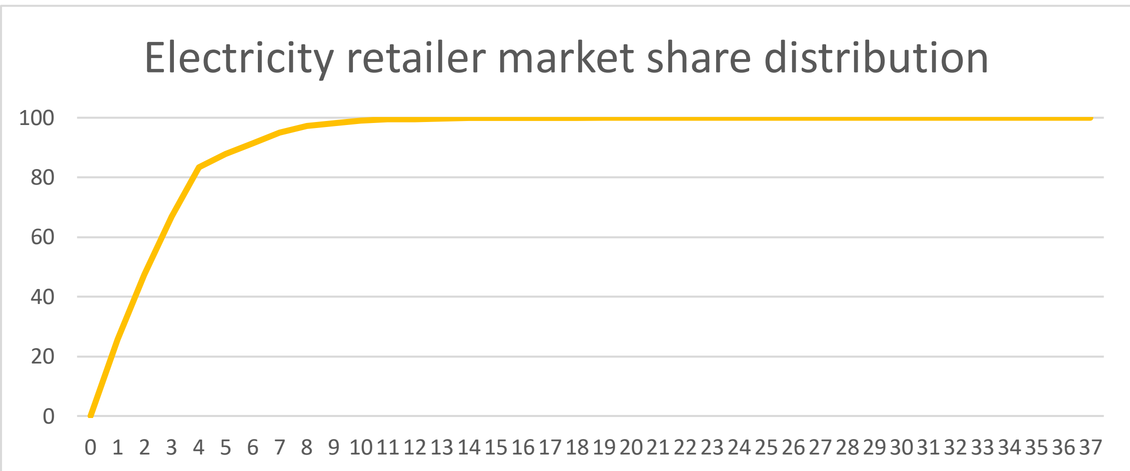
Proposition 1: The electricity retail market is concentrated/highly concentrated based on the Authority's definitions



Source: EMI

- No regional retail market meets the Authority definition of a competitive market (HHI under 1500).
- 32 out of 39 of the regional markets meet the Authority definition of a concentrated market (HHI between 1500 and 2500).
- 7 out of 39 meet the Authority definition of a highly concentrated market (HHI above 2500), with Waikato (2486), West Coast (2480) and North Canterbury (2442) on the margin.
- Tauranga (controlled by Mercury (née Trustpower)), Waitaki (Meridian) and King Country (Mercury) stand out as having exceptionally high levels of market concentration (HHI above 3000/close to 4000 in the case of Tauranga).
- The South Island HHI stalled between April 2021 and May 2022 (excluding the impact of Mercury's acquisition of Trustpower's retail business). The South Island HHI is the highest it has been since September 2019.

Proposition 2: The number of electricity retailers reflects the large number of very small retailers and not a highly competitive market

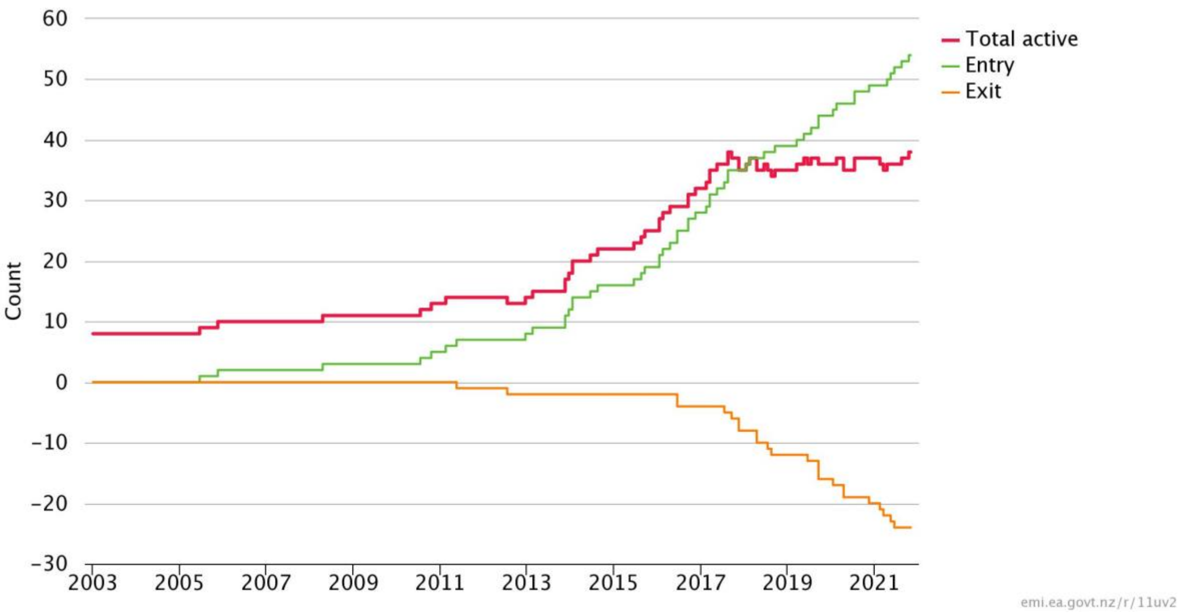


Source: EMI

- The electricity retail market has a large number of retailers (37) across New Zealand. However, we shouldn't be beguiled by the large number of retailers now in the market. This reflects the large number of retailers with very small market share:
    - Outside the 10 largest retailers, no electricity retailer has a national market share of more than 0.3%
    - Over a quarter have less than 10 customers
    - Nearly half (171 out of 37) have less than 100 customers
    - 86% have less than 10,000 customers (27 out of 37 have less than 5,000)

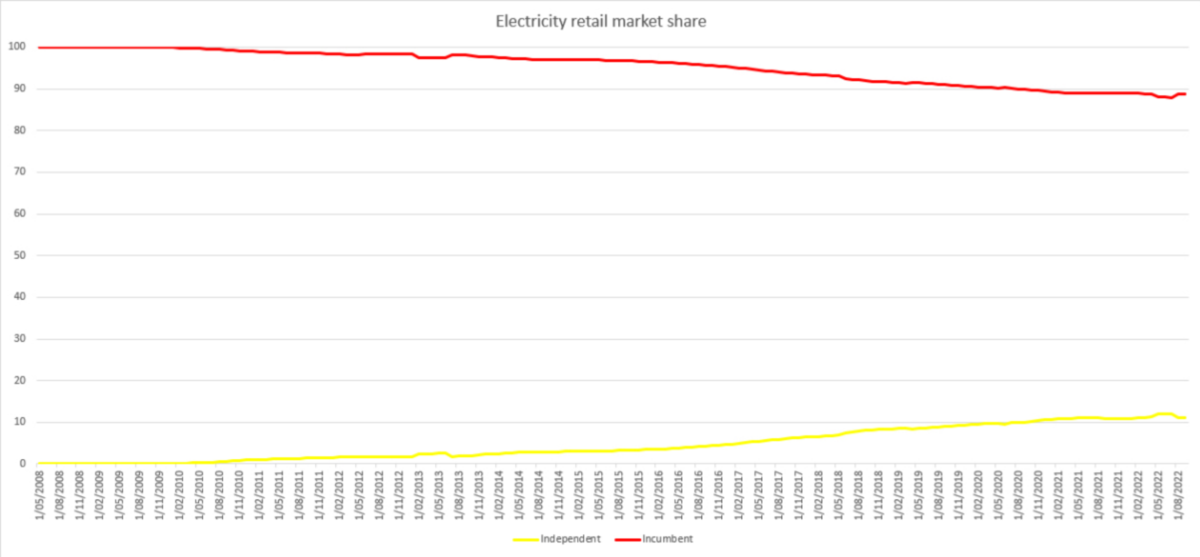
  This highlights that there are low barriers to entry but high barriers to growth and competition.

- The most notable thing about the number of retailers is that it has stalled – 38 in August 2018 and 37 at the end of September 2022 – during the current period of record high wholesale prices.
- 5 electricity retailers had exited the market prior to August 2018. The number has grown to 25 that have exited (nearly equally matched by new entrants).
- We agree with the ACCC that: "It is expected that businesses will enter and exit well-functioning markets. For example, businesses operating based on higher risk strategies or whose innovations fail will be prone to exiting the market at any time, particularly when disruptions occur. However, large numbers of retailers exiting the market (or becoming inactive) may negatively impact competition".[27]



[27] ACCC, Inquiry into the National Electricity Market, November 2022, available at: https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20-%20November%202022%20report.pdf.

Proposition 3: New entrant electricity retailer market growth is very slow



Source: EMI

- Independent retailer market share growth has been glacial.
- Independent retailer market share (ICP basis) has grown to 11.21% since June 2006 (less than 0.8% market share gain per annum in aggregate).
- Independent retailer growth has slowed or stalled at times during record high wholesale prices e.g. since the beginning of May 2021 aggregate independent retailer market share has grown just 0.22%.
- The 5 largest incumbent retailers share of the entire New Zealand retail market grew slightly for the first time in 2021.

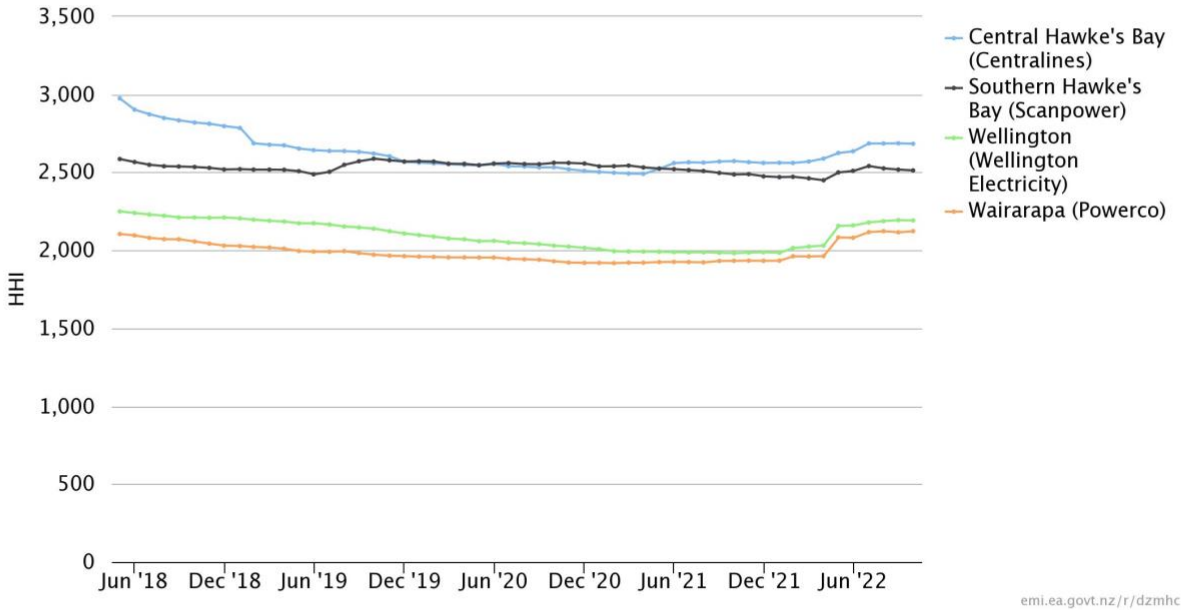
Share of Electricity Demand (MWh) - Including Direct Connected Industrial and Tiwai						
Year	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Total Volume	**41,169,924**	**41,173,325**	**41,701,610**	**41,161,759**	**41,288,217**	**34,718,104**
Independent	1,768,916	1,968,451	1,886,712	1,997,601	2,122,873	1,802,455
Gentailer	32,015,657	31,496,240	31,962,035	31,655,962	31,506,778	26,767,977
Tiwai	4,998,765	5,060,145	5,247,089	4,996,946	4,956,065	4,169,031
Other Industrial DC	2,386,586	2,648,488	2,605,775	2,511,251	2,702,501	1,978,641
Independent % Total	4.3%	4.8%	4.5%	4.9%	5.1%	5.2%
Gentailer % Total	77.8%	76.5%	76.6%	76.9%	76.3%	77.1%
Tiwai % Total	12.1%	12.3%	12.6%	12.1%	12.0%	12.0%
Other Industrial DC %	5.8%	6.4%	6.2%	6.1%	6.5%	5.7%

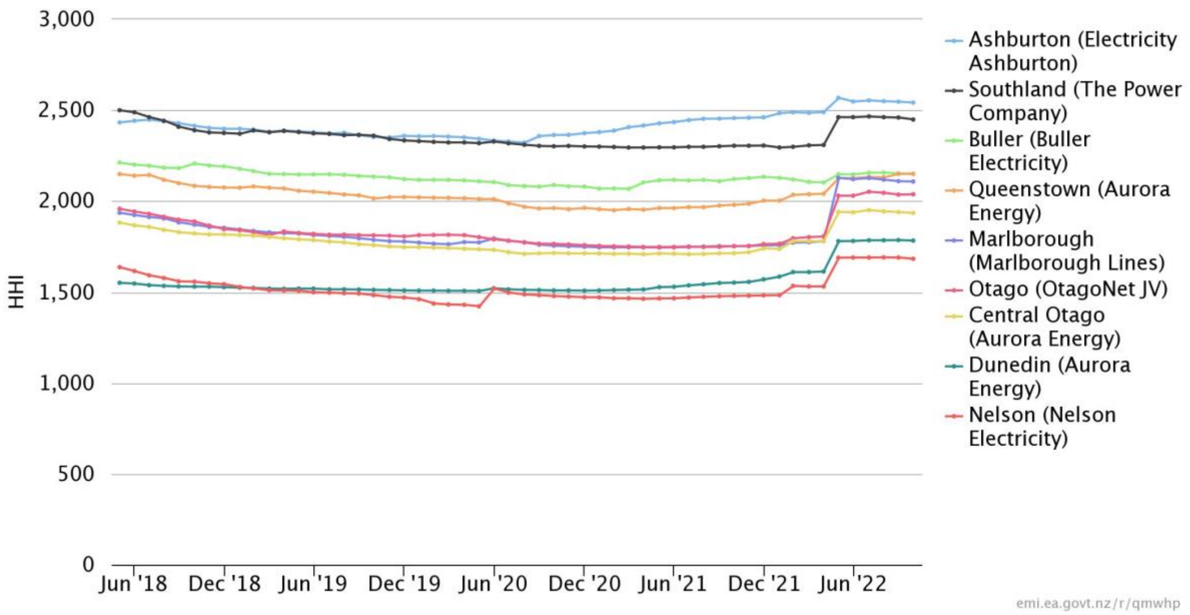
Share of Electricity Demand (MWh) - Excluding Direct Connected Industrial and Tiwai						
Year	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Total Volume	33,784,573	33,464,691	33,848,746	33,653,563	33,629,650	28,570,432
Independent	1,768,916	1,968,451	1,886,712	1,997,601	2,122,873	1,802,455
Gentailer	32,015,657	31,496,240	31,962,035	31,655,962	31,506,778	26,767,977
Independent % Total	5.2%	5.9%	5.6%	5.9%	6.3%	6.3%
Gentailer % Total	94.8%	94.1%	94.4%	94.1%	93.7%	93.7%

- The independent retailer market share outcomes are even worse when measured on a MWh basis rather than an ICP basis. Independent retailer market share sits at just 5.2% (including direct connect customers) or 6.3% (excluding direct connect customers).[28]

[28] Data sourced from EMI portal at: https://www.emi.ea.govt.nz/Wholesale/Datasets/Volumes/Reconciliation/2022, as at 05/12/2022.

Proposition 4: There are worrying reversals in retail market concentration statistics; particularly in the South Island

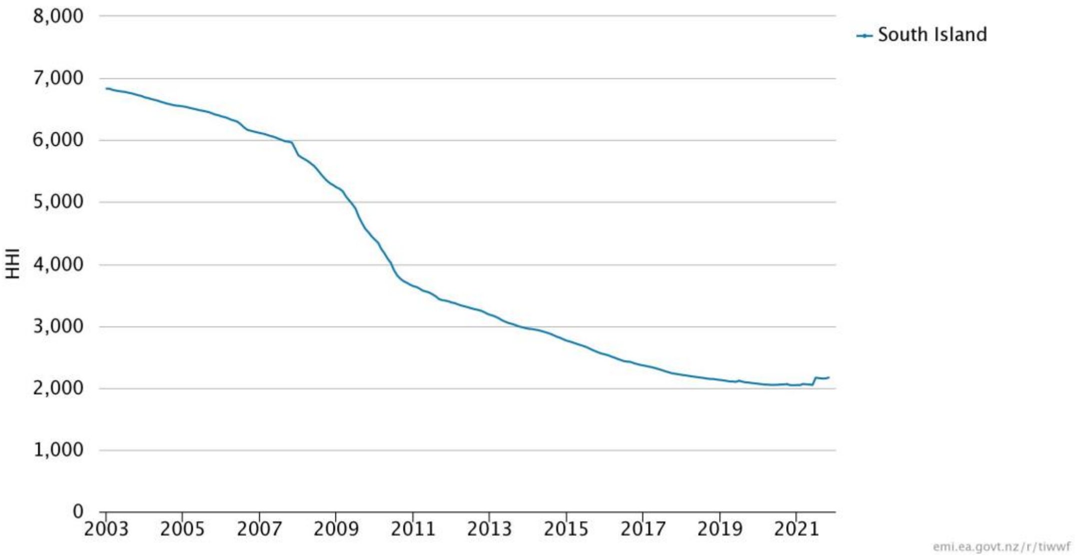


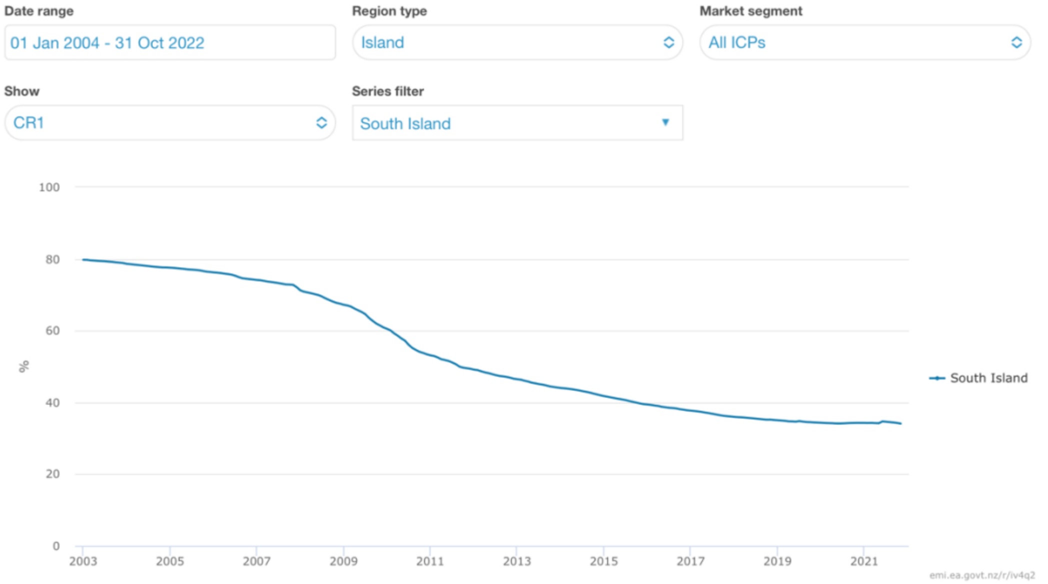


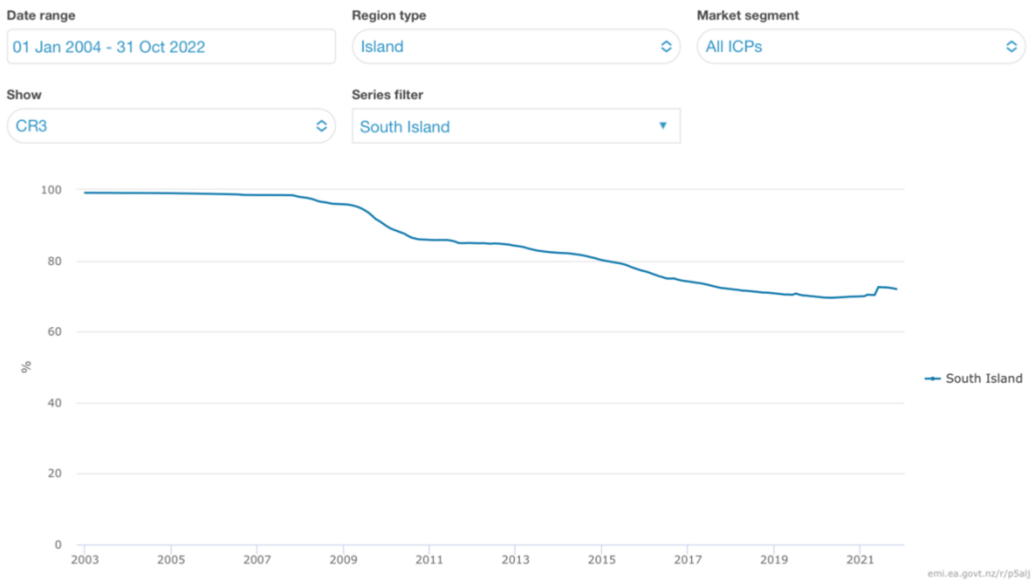
- The gradual improvements that had been occurring to market concentration statistics have stalled or worsened in many of the regional retail markets since wholesale prices have risen.
- This is notable in the lower North Island; Central Hawke's Bay (marginal improvement only) Southern Hawke's Bay, Wairapapa and Wellington, while regional retail markets such as Central Hawke's Bay have only slightly improved.
- It is also particularly pronounced across the South Island; Nelson, Malborough, Buller (marginal improvement only), Ashburton, Queenstown, Otago, Central Otago, Dunedin and Southland (9 out of the 16 South Island regional retail markets).

- Ashburton market concentration (HHI) has not improved compared to December 2015.

- The Ashburton CR1 has been getting worse since 2015.







- Market concentration in most South Island regional markets have either flatlined or deteriorated since the start of the WMR review period.
    - The South Island HHI and CR3 are about the same as mid-2018.
    - The South Island CR1 is about the same now as it was at the beginning of 2021, CR2 is about the same as mid-2019, and CR3 is about the same as mid-2018.

- South Island generation dominance is being mirrored in retail: As pointed out by Electric Kiwi and Haast,[29] "the two largest generators in the South Island, Contact and Meridian, are rapidly becoming the two largest retailers in the vast majority of network reporting areas". This is a clear trend with a one-off disruption due to Mercury's acquisition of Trustpower's retail business:
    - In 2000, Contact and Meridian were the two largest retailers in just 4 of the 16 South Island network reporting areas. This would now be 9 absent the one-off impact of Mercury's purchase of Trustpower's retail base).
    - In 2000, either Contact or Meridian was the largest retailer in 8 of the network reporting areas. This has now risen to 11 and would be 12 absent the one-off impact of Mercury's purchase of Trustpower's retail base).
    - The only South Island network reporting areas where Contact or Meridian are not the largest are Malborough (Meridian was on track to overtake Trustpower as largest retailer, prior to Mercury purchase), Buller (Pulse Energy is the largest retailer) and Westport (Mercury is the largest retailer, with Contact and Meridian in 2nd and 3rd place, respectively), Central Otago (Mercury thanks to purchase of Trustpower retail customer) and Otago (ditto).
    - There are only 2 regional markets in the South Island where Contact and Meridian are not both in the top 3 largest retailers (Buller and Ashburton).

[29] Electric Kiwi and Haast, The wholesale market has a $2.4 billion p.a. over-pricing problem, 17 December 2021, at: https://www.ea.govt.nz/assets/dms-assets/29/Electric-Kiwi-+-Haast-submission.pdf