10 October 2019

Brent Layton
Chair
Electricity Authority

cc James Stevenson-Wallace, Chief Executive, Electricity Authority

By e-mail: brent.layton@xtra.co.nz, james.stevenson-wallace@ea.govt.nz

Dear Brent,

Electric Kiwi urges winback ban before Christmas

Electric Kiwi welcomes the Electricity Authority's support of the Government's electricity reforms, and its commitment to "move at pace" and act "in the best interests of New Zealand electricity consumers". We are committed to assisting the Authority to implement the electricity reforms efficiently and expediently.

The winbacks problem alone means consumers are paying circa $500m per annum in loyalty taxes. This dwarfs the opportunities in the remainder of the Authority's work programme in terms of promoting the long-term interests of consumers.

The Government's announcement that there will be a ban on winbacks presents an opportunity for the Authority to 'hit the ground running' and can be the 'first cab off the rank'.

Implementing a ban on winbacks is a straight-forward reform and there is no reason why it couldn't be done prior to Christmas. The Expert Advisory Panel's final advice was that "the necessary change to the Electricity Industry Participation Code could be put into effect within three months, given we have already undertaken extensive stakeholder engagement on win-backs and only limited consultation should be needed".

The changes needed to implement an effective ban on winbacks are clear and straightforward

The Expert Advisory Panel's Final Report provided useful elaboration and direction on the nature of the changes needed to implement an effective ban on winbacks.

We agree with the Expert Advisory Panel that the ban should be "much like the one in the telecommunications sector" and should "go one step further and also prevent a retailer from acting on any private information it held on former customers for marketing purposes". This is consistent with submissions to the Authority on saves and winbacks which recommended adopting a rule that information obtained from the switching process cannot be used for saves and winbacks.

We suggest the Authority adopt the following Code amendment to implement the ban, and seek feedback on the drafting:

11.15AA Switch saving and winback protection [replaces clauses 11.15AA – AD]

(1) If a trader enters into an arrangement with a customer of another trader (the "losing trader") to commence trading electricity with the customer, the losing trader must comply with clause 11.15AA.

(2) A losing trader referred to in subclause (1) must not use any information obtained from a notice of the switch request under clause 22(a) of Schedule 11.3 for any other purpose than to facilitate the switch of the customer.

(3) A losing trader referred to in subclause (1) must not use any private information or contact details it holds on a customer that has switched, to another trader, or for whom the losing trader has received notice of the switch request under clause 22(a) of Schedule 11.3, for any other purpose than:

  (a) contacting a customer to advise the customer of any termination fees that the customer is required to pay as a result of the customer ceasing to trade with the trader; or

  (b) contacting a customer regarding administrative matters, including—
    (i) any fees the customer owes the trader:
    (ii) the customer's final meter reading:
    (iii) how the trader will return any keys it holds on the customer's behalf:
    (iv) the effect of the customer ceasing to buy electricity from the trader on other contracts between the customer and the trader, for example, for the supply of gas.

The Expert Advisory Panel Final Report means the Authority can safely reject the advice it received from MDAG

The Authority submitted to the Expert Advisory Panel that, while it "understands the concerns raised by the panel and some submitters about win-backs stifling retail competition and having adverse consumer impacts", it "also … received advice from our Market Development Advisory Group (MDAG) that there is no evidence of a market or regulatory failure associated with win-backs".

With respect to the advice the Authority has received on winbacks, Electric Kiwi considers the MDAG Recommendations Paper is hopelessly flawed and has no probative value.[1] The Expert Advisory Panel had the opportunity to consider the MDAG Recommendations Paper before it submitted its Final Report to the Minister, and reached the following conclusions:

> The … big retailers and the BusinessNZ Energy Council (with a dissenting view from one member) opposed a ban. Mercury and Trustpower said the Electricity Authority's Market Development Advisory Group had reviewed the matter extensively and found no evidence winbacks were harming competition. However, that review did not weigh wider fairness considerations. Nor were its findings categorical. It said "there is no strong evidence of regulatory problems or market failures" but added that "evidence that there are problems arising from the use of saves and win-backs, or not, are relatively thin such that no robust conclusions can be drawn one way or the other". By contrast, <u>we found convincing evidence win-backs restrict retail competition by raising costs for rivals of the vertically integrated companies</u>. [emphasis added]

The Expert Advisory Panel had sound basis for determining a ban on winbacks would be to the long-term benefit of consumers. Electric Kiwi endorses the Panel's statement that "We place significant weight on the fact submissions from consumers and new retailers overwhelmingly supported a ban. We also know a ban is no leap in the dark because the telecommunications sector has applied a similar ban for years". We also note equivalent investigations by the ACCC in Australia and CMA in the UK reached similar conclusions that there were substantial 'loyalty taxes' (consumers paying too much), these disadvantaged those most in need, and policy changes were needed to address the problem.

[1] Our assessment of the MDAG Recommendations Paper is appended to this letter.

Concluding remarks

Adopting a pre-Christmas ban on winbacks would provide a clear and unambiguous statement of intent that the Authority will implement the Government's electricity reforms with urgency. Given the winback problem is costing consumers over $40m per month in excessive charges or 'loyalty taxes' the changes can't happen fast enough. The Expert Advisory Panel has indicated this equates to about $240 per household per year. Based on UK and NZ[2] surveys the consumers who are paying too much are over-represented by low income households and the elderly, who can least afford high electricity prices. The next step for the Authority should be to implement Code amendments with urgency which mirror the Expert Advisory Panel specifications for a winback ban, including restrictions on customer information usage. We also consider that the Authority should take ownership of the reforms and the matter should not be handed back to MDAG.[3]

I would be happy to discuss Electric Kiwi's views further, including in relation to the pathway to efficiently and expediently implement the Government's electricity reforms.

Yours sincerely,

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[2] Consumer NZ, Energy providers survey, 7 June 2018.
[3] Electric Kiwi has written separately to the Electricity Authority about our concerns with MDAG.

Appendix: The problems with the MDAG advice on saves and winbacks

With respect, the MDAG Saves and Winbacks Recommendations Paper represented a retrograde contribution to the saves and winbacks/two-tier retail market issue and has little to say relevant to the extent to which there is a problem, or what regulatory changes are needed to address this problem.

The MDAG Recommendations Paper has no probative value. It contains little or no relevant quantitative analysis or evidence and relies on subjective and qualitative dismissal of arguments that weren't raised in submissions and aren't relevant to whether there is a two-tier market/saves and winbacks problem. MDAG were explicit they considered the actual two-tier retail market/saves and winbacks problem (whether prices are higher than they otherwise would be) to outside of the scope of their review, rendering the MDAG review largely irrelevant.

What MDAG needed to do was investigate whether saves and winbacks resulted in or contributed to a market in which there are retail 'tiers' of customers (effectively a monopoly customer base) that is charged excessive or monopoly prices. As Vocus has noted:[4]

> 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. 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. [footnote removed]

This is the approach that was undertaken in equivalent Australian and UK investigations.[5] MDAG not only did not do this, but they actively ignored evidence of excessive pricing, including from the Electricity Price Review (EPR) and the Electricity Authority's own data.[6]

The saves and winbacks/the two-tier retail market is one of the most substantive retail competition issues the EPR identified (with detriments to consumers in excess of half-billion dollars per annum). There is a broad agreement amongst consumer representatives, independent retailers, and electricity networks (and their trust-owners) that this is a problem. The MDAG position aligns exclusively with the position of the majority of incumbent retailers.

While MDAG has noted that "The Electricity Price Review panel has put forward an option of prohibiting saves and winbacks" and "their assessment takes into account wider fairness considerations" the EPR Panel conclusions do not hinge on fairness issues, as these simply reinforced the consumer benefits from prohibiting saves and winbacks.

[4] Vocus, Submission on Electricity Price Review Options Paper, 22 March 2019.
[5] Electric Kiwi, Supplementary submission on "Customer acquisition, saves and win-backs – Issues Paper": helpful guidance from the ACCC, 17 July 2018.
[6] It is notable that the Electricity Authority ceased undertaking its assessment of the benefits of switching (the 'loyalty tax') after the information was used in submissions in response to MDAG. The latest update was for 2017, which indicated the size of the loyalty taxes was growing substantially.

Summary of the problems with MDAG's Recommendations Paper

- We agree with Vocus that "The Electricity Authority Advisory Group's, MDAG, position that saves and winbacks isn't a problem is out of step with not only the [Expert Advisory] Panel, but also the ACCC and the UK Competition and Markets Authority (CMA)".[7]

- The MDAG Recommendations Paper has no probative value. It contains little or no relevant quantitative analysis or evidence and relies on subjective and qualitative dismissal of arguments that weren't raised in submissions and aren't relevant to whether there is a two-tier market problem.

- MDAG concluded correctly that "There does appear to be an upward trend in the use of saves and win-backs" but went on to claim "evidence that there are problems arising from the use of saves and winbacks, or not, are relatively thin such that no robust conclusions can be drawn one way or the other". The reason the evidence in the MDAG report is "thin" is simply because the report ignored the actual two-tier retail market/saves and winbacks problem and did not consider whether saves and winbacks resulted in or contributed to a market in which there are retail 'tiers' of customers (effectively a monopoly customer base) that are charged excessive or monopoly prices.

- The MDAG review needed to consider whether saves and winbacks resulted in or contributed to a market in which there are retail 'tiers' of customers (effectively a monopoly customer base) that is charged excessive or monopoly prices. The MDAG review did not do this. MDAG instead asserted "Our evaluation is not concerned with direct examination or diagnosis of problems relating to market performance – such as high average prices or distributional concerns".

- The MDAG review also excluded key components of the two-tier retail market/saves and winbacks problem from the scope of the review, including: the information advantage the losing retailer has over gaining retailers, matters relating to affordability and price discrimination, lack of consumer engagement and matters regarding price transparency. It is not clear why these were all excluded. The Electricity Authority only directed MDAG that the information advantage the losing retailer has was out of scope.[8] The other exclusions weren't mentioned in the project scope or the MDAG consultation and were mentioned for the first time in the MDAG Recommendations Report.

- MDAG established a series of 'strawman' or 'Aunt Sally' arguments that it could readily dismiss. For example, MDAG asked itself: "Is the market trending towards increased occurrence of market dominance?" even though there is no apparent or obvious reason why the two-tier retail market/saves and winbacks problem would result in or increase market dominance. This is the equivalent of rejecting cancer drugs because they failed to cure the common cold.

- The MDAG review effectively assumed the saves and winbacks problem away.

[7] Vocus, Submission on Electricity Price Review Options Paper, 22 March 2019.
[8] Letter from Carl Hansen (CEO, Electricity Authority) to James Moulder (Chair, MDAG), Market Development Advisory Group work plan – response to expression of interest in additional projects, 18 December 2017. MDAG, Customer acquisition, saves and win-backs – Issues Paper, 22 May 2018, Footnote 7.

- We also find it problematic that MDAG dismissed submissions to the EPR on the factually incorrect basis that “none of these were [sic], in our view, differed substantially from information provided directly to MDAG”. We find this comment quite extraordinary. 25 stakeholders submitted in support of a ban on winbacks that had not submitted to MDAG, all of which supported a ban on winbacks.

- It is a matter of factual observation that submissions to the EPR included new and substantive information. For example, Entrust’s submission included quantitative evidence from a UMR survey that provided clear evidence the conditions for a two-tier retail market existed, including that large numbers of consumers thought they were getting a good deal even when they could make substantial savings by switching retailer, and consumers who had never switched thought switching was much more difficult and risky than it actually is. This creates a ‘perfect storm’ for a two-tier retail market/successful saves and winbacks strategy for incumbent retailers.

MDAG reviewed winbacks/two-tier retail market issues while treating the central two-tier retail market problem (higher prices) as out-of-scope

To determine whether winbacks are to the long-term benefit of consumers or not, MDAG needed to investigate whether winbacks enable incumbent retailers to retain higher average prices than otherwise. MDAG (correctly) noted that:

> “Two categories of concern were expressed. One was that prices are, on average, higher than they should be (would otherwise be) and that this is due to market structure (“monopoly” pricing) and conduct including, but not limited to, saves and win-backs behaviour. The other, related, concern was about the distributional consequences of prices being higher than they should be. The concern is that prices are highest for those that are least able to afford those higher prices. While some consumers are benefitting from lower prices submitters say that these benefits are not available to all consumers (Entrust) and are least likely to accrue to poorer households (Ecotricity, Electric Kiwi).
>
> “The other, related, concern was about the distributional consequences of prices being higher than they should be. The concern is that prices are highest for those that are least able to afford those higher prices. While some consumers are benefitting from lower prices submitters say that these benefits are not available to all consumers (Entrust) and are least likely to accrue to poorer households (Ecotricity, Electric Kiwi).”

MDAG did not do the work it needed to on whether “prices are, on average, higher than they should be”. MDAG side-stepped consideration of these substantive concerns about winbacks, by asserting:

> “Our evaluation is not concerned with direct examination or diagnosis of problems relating to market performance – such as high average prices or distributional concerns.”
>
> “Customer segmentation and non-uniform pricing, for example, are not market failures or regulatory problems and thus not considered directly in our evaluation.”

It is difficult to see what the point of the MDAG review was, given it excluded consideration of the actual two-tier retail market/saves and winbacks problem. Any competition policy review which ignores evidence of monopoly pricing (no mention is made in the report of the two-tier market or loyalty taxes) and what the OECD describes as “exploitative discrimination” is without any merit. The MDAG approach is equivalent to the Commerce Commission undertaking an investigation into whether a supplier should be price controlled without considering whether they are earning, or could earn, excessive returns. Or, put another way, MDAG’s approach is equivalent to the Authority reviewing RCPD charges while treating whether they are inefficiently high or not as out of scope.

The MDAG draft Saves and Winbacks Recommendations Paper provides no useful contribution to the saves and winbacks/two-tier market issue

MDAG reached the conclusion "There is no strong evidence of regulatory problems or market failures related to customer acquisition and switching processes, including saves and win-backs practices", by avoiding the main issues that: (i) winbacks is a key enabler of the two-tier market; and (ii) the outcome is that incumbent retailers are able to maintain average retail prices at higher levels than they otherwise would be able to (the "loyalty tax").

Instead of investigating whether there was a two-tier retail market, MDAG occupied itself with several alternative, and largely irrelevant, strawman or 'Aunt Sally' arguments which it could readily dismiss, and use to support its case that there isn't a problem. MDAG avoided engaging with actual submissions and actual arguments included in the submissions e.g.:

- Instead of considering whether there are market power or concentration issues, MDAG asked: "Is market dominance a problem in the retail market?" No submitter argued this that we are aware of. The two-tier market problems do not require market dominance.

- MDAG asked itself: "Is the market trending towards increased occurrence of market dominance?" No submitter argued this that we are aware of. It is not obvious why MDAG would consider this was something that needed to be tested, beyond that it is an easy (made up) argument to shoot down.

- MDAG asked itself: "Have saves and win-backs reduced consumer engagement?" No submitter argued this that we are aware of. Issues of low levels of consumer engagement, amongst certain groups of customers, is one of the enablers or causes of the two-tier retail market, not something that is increased by saves and winbacks. MDAG have confused cause with outcome.

MDAG also considered peripheral issues such as whether winbacks were part of anti-competitive behaviour (possible but not necessary for winback to be successful or a problem) or part of misleading conduct. MDAG also relied on spurious or irrelevant information such as the comment "The fact that win-backs are most prevalent between larger retailers is significant evidence of this". What is relevant and significant evidence is the extent to which the incumbent retailer is successfully engaging in winbacks. The fact that winbacks are most prevalent amongst larger retailers tells us no more than that the large retailers have a larger market share than smaller retailers. The statement of fact MDAG considered "significant" was nothing more than a tautological observation.

MDAG failed to consider the three pillars which enable a two-tier retail market

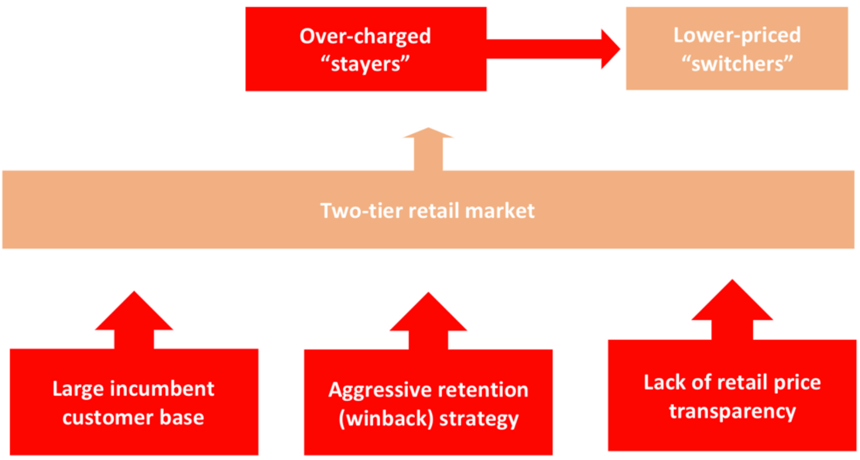
The MDAG paper made reference to the fact Electric Kiwi and other submitters raised the issue of price discrimination and how this could result in excessively high prices and a "two-tier" market "where customers that do not switch or do not receive win-back discounts are not benefitting from competition". MDAG didn't comment on the merits of these arguments, and the two-tier market problem wasn't mentioned again (it was only referred to once in the paper). The exclusions from the scope of the project effectively assumed the two-tier retail market/saves and winbacks problem away.

These are important elements of the three pillars which enable a two-tier retail market, which were detailed in various of the submissions to both MDAG and the EPR:

Three pillars which enable a two-tier retail market	Exclusions from MDAG scope[9]
1. The incumbent retailers have a high number of stayers or customers that have never switched (the monopoly customer base) – MDAG has loosely referred to this as "consumer inertia" and "a high degree of concentration in the retail market",[10]	"... matters considered outside scope for this review are: ... lack of consumer engagement leading to inequitable outcomes"
2. The incumbent retailers can exploit the stayer customer base by engaging in price discrimination (which the OECD defines as "undue discrimination"), and	"... matters considered outside scope for this review are: ... matters relating to affordability and price discrimination"
3. Information asymmetries and winbacks[11] help enable the incumbent retailers to retain price discrimination without losing larger numbers of customers.	"A losing retailer's informational advantage is one issue specifically outside the scope of the terms of reference for the MDAG's review." "... matters considered outside scope for this review are: ... matters regarding price transparency"

The three pillars that enable two-tier retail markets is illustrated by Figure 1.

Figure 1: Saves & Winbacks is one of the pillars enabling two-tier retail markets



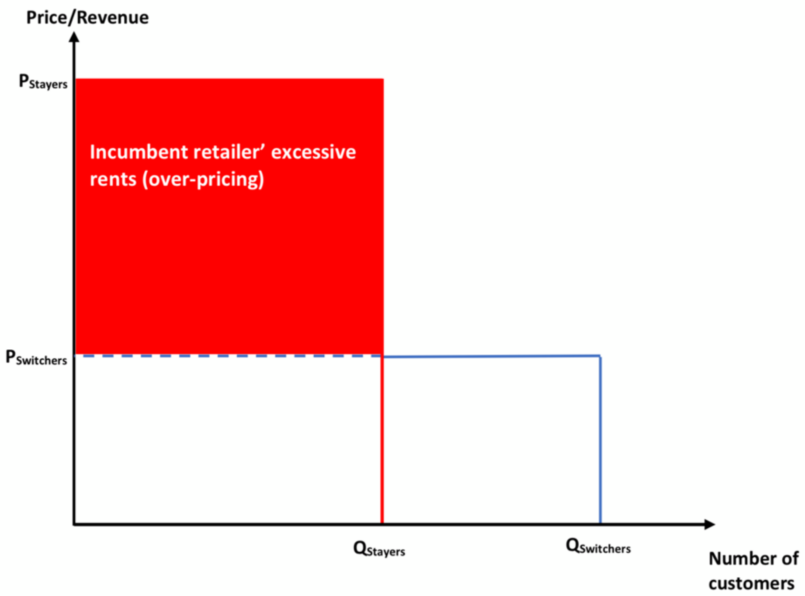
The type of two-tier retail market/saves and winbacks analysis MDAG should have undertaken

The central part of the MDAG investigation should have been to establish the number of tiers in the retail market, and the size of the 'loyalty taxes'. The Expert Advisory Panel undertook this type of analysis as part of its review.

[9] It is unclear what the origin of these exclusions from the project scope is. They are only first mentioned in the MDAG Recommendations Report.
[10] MDAG cited the 88% market share of the 5 largest retailers, but what is actually relevant is the market share of the incumbent retailer.
[11] MDAG have noted that "retailers that lose customers have access to information about customers that enables them to offer departing customers a discount to win them back".

The Electric Kiwi submission to MDAG on Saves & Winbacks included the following stylised diagram (Figure 2). For simplicity the stylised diagram only included two-tiers, but the reality is there are multiple tiers.

Figure 2: Incumbent retailer market segmentation and monopoly pricing problem



MDAG could have replicated the diagram using actual pricing data for each network reporting region, including establishment of the number of tiers. The ACCC provided this information on the tiers (see Figures 3 and 4 below).

Figure 3: Multiple tier retail market

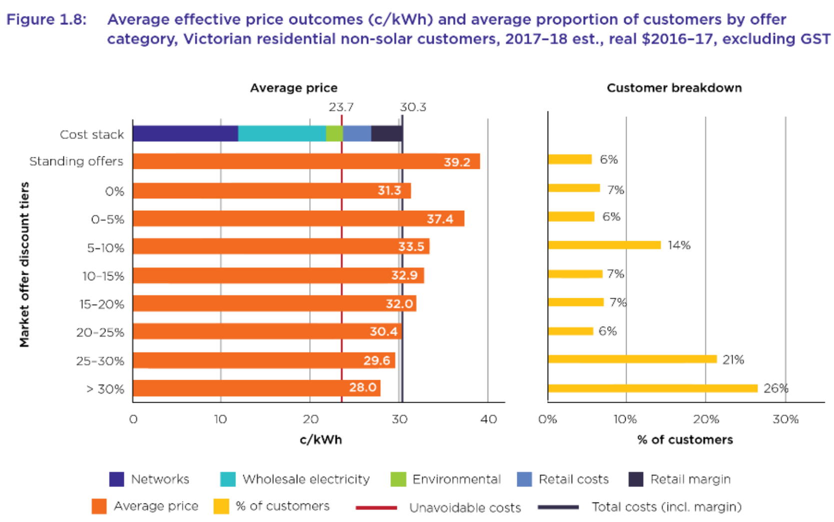
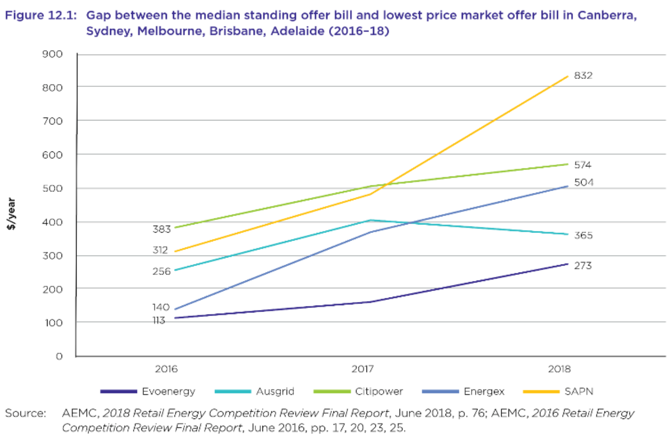


Figure 4: Multiple tier retail market by region

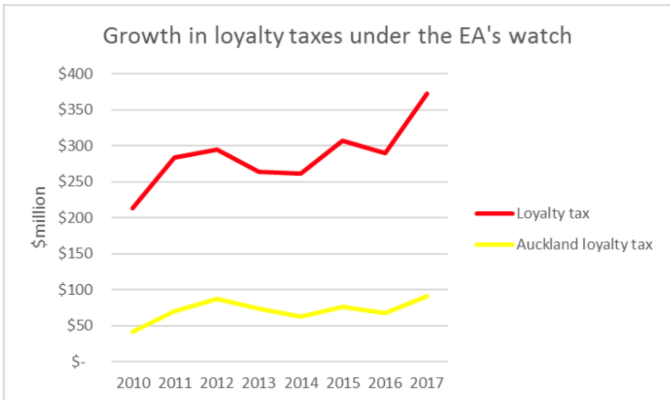
MDAG could have also undertaken a time-series analysis to show how the size the tiers have changed over time (as per Figure 5 below).

Figure 5: Growth in the gap between the tiers



Entrust undertook this analysis based on EMI data for Auckland and New Zealand.

Figure 6: Entrust calculation of the size and trend in "loyalty tax" based on EMI data



Source: EMI residential savings league table [understates the size of the loyalty tax]

Analysis of incumbent retailer retention strategies

The following two graphs are updated versions of graphs we submitted to the EPR. It could have been useful for MDAG to have replicated this analysis for the incumbent retailers in each network reporting area and assessed whether there was a relationship between the level of incumbent retention (saves and winbacks) and the size of the loyalty tax.

Figure 7: Mercury's residential customer retention in Auckland

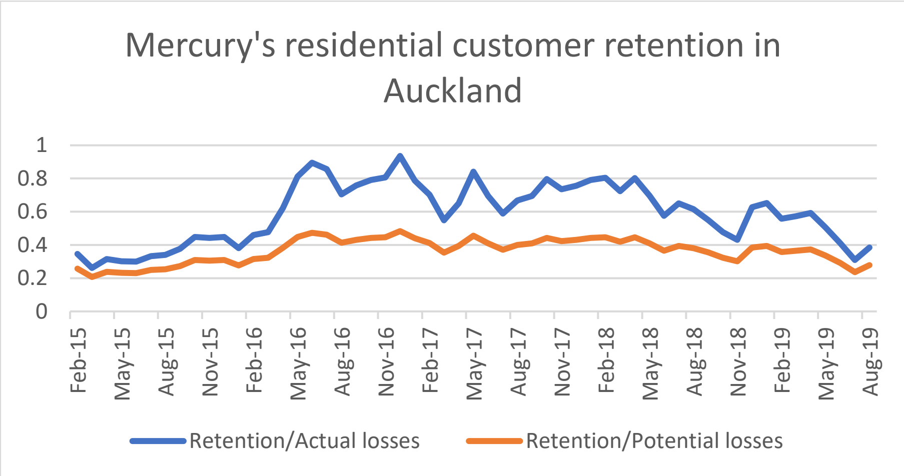
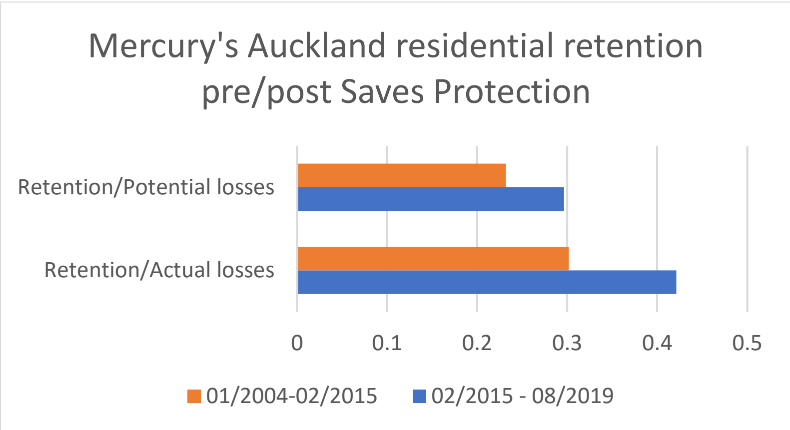


Figure 8: Mercury's Auckland customer retention before and after Saves Protection



Additional information from EPR submissions

The MDAG Recommendations Paper claimed "Many of the submissions to the report of the Electricity Price Review's Expert Advisory Panel did raise matters of relevance to MDAG's review" but then (incorrectly) claimed "none of these were [sic], in our view, differed substantially from information provided directly to MDAG". We find this comment quite extraordinary. 25 stakeholders submitted in support of a ban on winbacks that had not submitted to MDAG. It is a matter of factual observation that submissions to the EPR included new and substantive information.

We detail some of the additional information from the EPR submissions below.

We consider it is relevant that:

- A substantially larger number of stakeholders were prepared to engage on the saves and winbacks/two-tier retail market issue in response to the EPR consultation than the MDAG consultation. 33 submissions supported a ban on winbacks compared to 8 submissions to MDAG.

- There is clear and substantial majority support for a ban on winbacks.

- All independent retailers and consumer groups support ban on winbacks.

- All electricity distributors, and Shareholding Trusts, with the exception or Aurora and Orion supported ban on winbacks. Aurora and Orion were undecided or silent.

- The only stakeholders that do not favour a ban are 5 of the 6 incumbent retailers (Contact being the notable exception).

Ban winbacks	Do not favour ban	Undecided/other
Buller Electricity	Genesis*	Aurora
Community Power	Mercury*	Business NZ
Consumer NZ	Meridian*	Commerce Commission
Contact	Nova*	Electricity Authority
Counties Power	Trustpower*	MEUG
Counties Power Consumer Trust		Orion
Ecotricity*		Winstone Pulp
Electric Kiwi*		
Entrust*		
energyclubnz*		
ETNZ		
Expert Advisory Panel		
ENA		
Federated Farmers		
Flick*		
Grey Power		
Joint Independent Retailers		
The Lines Company		
Lines Trust South Canterbury		
Network Waitaki		
NorthPower		
Pioneer Energy*		
Pulse*		
PwC Distribution Group		
Refining NZ		
Salvation Army		
Saveawatt & One Big Switch New Zealand		
Sustainability Trust		
Top Energy		

Ban winbacks	Do not favour ban	Undecided/other
Utilities Disputes		
Vector		
Vocus*		
Wellington Electricity		
* Stakeholders that submitted to MDAG		

Entrust's EPR submission UMR survey included substantive new evidence that was not considered by MDAG

The submissions to the EPR also contained substantial new and additional information that had not been in front of MDAG. Entrust's submission to the EPR provided extensive factual evidence from a UMR study they commissioned, directly relevant to the two-tier retail market/saves and winbacks issue. The study highlighted that:

> Despite the fact large numbers of loyal customers are being overcharged and not on the right or best deal, the perception of most our beneficiaries, and other Auckland consumers, is that they are on the right deal for their household. 74% of consumers were confident they are on the right deal.
>
> 27% of consumers thought it was difficult to compare prices (versus 39% who didn't).
>
> 40% of consumers worried something would go wrong if they switched, which was higher amongst those that have never switched (46%).
>
> Just over 35% thought switching electricity retailers is difficult and can take too long (41% of consumers who had never switched).
>
> … Among those that had not switched only 42% thought it would be easy, versus 23% thought it would be difficult.[12]

What Entrust presented was a 'perfect storm' which, to mix metaphors, supports the three pillars of the two-tier market:

> … the UMR survey results highlight is consumers who remain loyal to the big-5 retailers don't know the true extent to which they are being overcharged, or that they would be better off switching supplier. The information gap helps keep consumers who haven't switched loyal to their retailer. The incumbent retailers will be well aware of this and will have much more segmented data than we have obtained through the UMR survey. They will be well aware of the magnitude to which they can exploit their most loyal customers.

[12] UMR, Consumer research on electricity usage and supply issues, October 2018.