1 November 2022

Submissions
Electricity Authority
Wellington

By e-mail: appropriations@ea.govt.nz

Funding proposals should have a clear focus on "consumer centricity" and "thriving competition"

2degrees, Electric Kiwi, Flick Electric, OurPower and Pulse (the independent retailers) recognise the need for the Electricity Authority and Commerce Commission to be well-resourced, high-calibre regulatory institutions for a successful and competitive electricity industry which delivers affordable electricity and the long-term interests of (end-)consumers.

Our interests are aligned to the Authority's statutory objective and the Authority successfully achieving its strategic ambitions.

While the Authority has been clear it "is not concerned with the outcomes for individual competitors in the process, except to the extent that it impacts on the long-term benefit of consumers"[1] the reality is that if the Authority succeeds in promoting thriving competition it will benefit consumers (which should be the Authority's principal focus) and new and independent suppliers at the expense of incumbent interests. In some circumstances, protecting the process of competition can have the effect of protecting a competitor.[2]

The independent retailers support funding that has a clear and direct consumer and competition focus. We would specifically support extra funding for the Authority: (i) to expedite projects for development of competition (both wholesale and retail), including more rapid prioritisation of the wholesale market review (WMR); (ii) to ensure Powerswitch is fully levy-funded; and (iii) as part of the upgrade of the Authority's monitoring and compliance enforcement.

Summary of the independent retailers' views on the Authority appropriations and budget planning

- **The independents support the proposal for an additional $1.08m in 2023/24 and $2.16m in 2024/25 and out-years for the WMR**. The Authority's latest thinking focuses on constraining rather than removing market power through behavioural regulation and a longer-term focus on facilitating new investment.[3] This indicates competition issues will remain an ongoing and substantial issue requiring regulatory attention for the foreseeable future.

[1] Electricity Authority, Re: Flick Electric submission to the Petitions Committee on market pricing and vertical-integration in the electricity market, 27 May 2022.
[2] Commerce Commission v Fletcher Challenge Ltd [1989] 2 NZLR 554 (HC) at 604; and Union Shipping NZ Ltd v Port Nelson Ltd [1990] 2 NZLR 662 at 700.
[3] The Authority has noted that the long-term trend for the HHI is that it is not decreasing and has flattened out since 2012. Concept Consulting projects for the Authority indicate the HHI could be between 1800 and 2200 in 2025 and between 1200 and 2300 from 2030.

- **It does not appear that the 23% total increase (+$5.837m) in operating expenses for FY23/24 is well supported by the information provided in the consultation paper.** We would like to see information on what makes up the large increase in order to comment.

  The Authority has stated that it "will take part in an independent baseline review of the Authority's operations prior to consulting on a specific increase to appropriations for 2024/25". We would like to see this review ahead of the proposed increase in FY 23/24.

- **The Authority should consult on its annual work programme in conjunction with appropriations:** It would be helpful to understand how the budget will impact the work programme and key milestones so it is clearer what would be delivered with any extra funding.

- **Retail competition issues need to be included in the workplan:** The Authority's survey of market participants provides evidence of widespread concerns about retail competition. It is difficult to see how the survey results will improve at this point in time. Our submission in response to the October 2022 WMR consultation details concerns about the state of the retail market.

- We welcome that the Authority is now looking into "issues that may be preventing smaller market participants from accessing hedge contracts as a risk management arrangement". This is a critical part of the Authority work programme which should be given high priority.

- **The Authority review of distribution pricing should include a focus on 'menu costs':** The large number of electricity distributors (EDBs) means there is inevitably going to be a large range of network access tariffs across New Zealand in contrast to telecommunications. This can be multipled in magnitude by the number of different tariffs each EDB sets for different customers (particularly in relation to smaller EDBs). This can result in a long pricing cycle, particularly for changes to residential tariffs which is indicative of cost in the system that reduces agility and innovation.

- **The Authority should undertake a review of the performance and accuracy of Powerswitch:** We consider that a review should be undertaken in 2022/23. Given: (i) the Authority's levy-funding of Powerswitch; and (ii) regulation requiring retailers to promote Powerswitch to their customers, it is important the Authority ensures Powerswitch is fit-for-purpose and safe to rely on by consumers deciding whether to change retailers. Based on current Powerswitch settings there is likely to be a high incidence of false-negatives (consumers being directed to more expensive retailer and tariff options).

- **The Authority should review the current funding arrangements for Powerswitch.** It is not clear that Powerswitch requires more funding than provided by the Authority or what service the Authority and Consumer NZ agreed would be provided from the funding. It is also unclear why a hybrid levy:retail sales commission funding model would be desirable. We consider the funding arrangements should be reviewed and consulted on. The requirement to promote the site regardless of whether you are represented on it provides Consumer NZ a pseudo monopoly status when it comes to setting fees.

  The way Consumer NZ chooses to set Powerswitch fees – on a retail sales commission basis – is a 'tax on competition' which favours incumbent retailers at the expense of small and new entrant retailers. We consider that Powerswitch should be fully levy-funded.

- **The Authority should reinstate its review of the interpretation of its statutory objective.** A pure focus on efficiency will not deliver long term benefits for consumers.

The independent retailers support the Authority's desire to be a world-class regulator

The independent retailers share the Authority's desire to be ambitious for Kiwi consumers and see thriving competition as important for driving the transition to electrification and a low-carbon economy.

We have been pleased to have been able to provide the Authority with 'bouquets' and support in submissions for its robust work on, for example, the Consumer Care Guidelines, saves and winbacks,[4] the initial wholesale market review consultation, inefficient price discrimination ('Tiwai'), and the MDAG trading conduct and renewables projects.

We have felt an increasing need to defend the Authority from what is sometimes undue criticism and would be able to do so more often if cross-submissions were the norm rather than exception. The initial WMR and inefficient price discrimination consultation are examples where we considered the Authority received unjustified criticisms, including from its ex-CEO, but we didn't have an opportunity to refute the criticisms.

The step-change in the quality of the work output and stakeholder engagement by MDAG in its trading conduct and renewables projects is a notable success story the Authority should be proud of and sets a benchmark for all other projects.

Ongoing high level of staff turnover is a concern

On the other-side of the ledger, we are conscious the Authority is going through an extended period of instability and upheaval.

The very high staff turnover in the last three years has been disruptive and should be of significant concern to everybody; including the loss of institutional knowledge and some particularly high calibre staff who are well respected in the sector.[5]

It appears that part of the Authority's reason for reliance on consultants isn't just because "the Authority needs access to highly technical expertise" but also because of staffing issues and reliance on consultants has extended beyond specialist expertise to core elements of the Authority's role.

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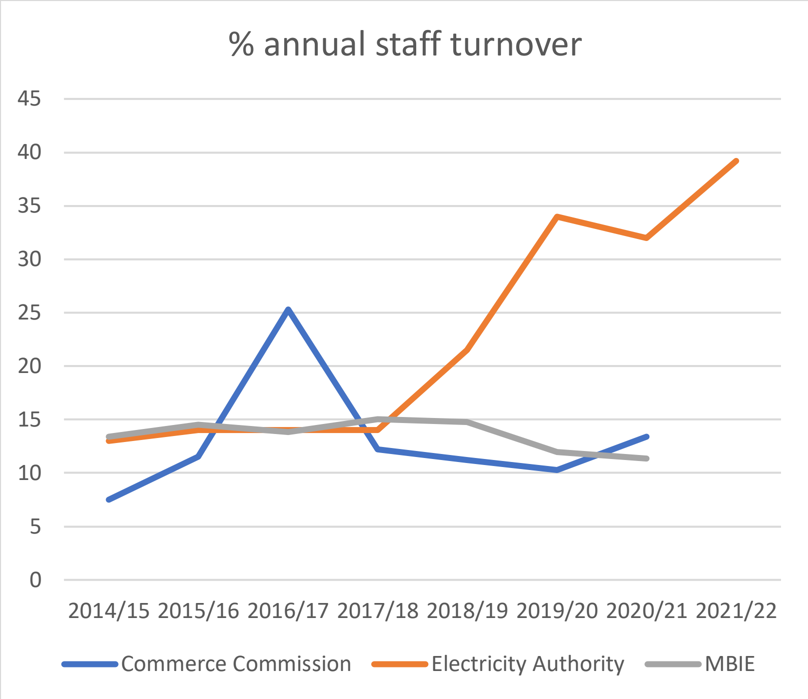
[4] Excluding the work undertaken by MDAG.

[5] It appears the high level of staff turn-over has resulted in increased reliance on consultants not just for "highly technical expertise" but also for what should be core, in-house capability. It is not clear the Authority has been successful in its intent to "continue to pursue efficiencies in our operations through initiatives including … reducing reliance on external consultants": https://www.ea.govt.nz/assets/dms-assets/24/243462019-20-Levy-funded-appropriations-and-indicative-work-programme-Consultation-paper.PDF



In 2020/21, the Authority claimed "The turnover rate is no different from other agencies at this point in time as people move around in response to a talent shortage". It is unclear which agencies the Authority was referring to. The level of turnover at the Authority is in stark contrast to MBIE and the Commerce Commission, which are the most directly comparable agencies and have had low turnover in the same time-period.[6] MBIE turnover declined during COVID. The Authority turnover rate is substantially higher than the public sector average of about 17%.

High quality of work on trading conduct etc sets the bar for other Authority workstreams

Unfortunately, we have observed considerable variability in the Authority work, mirrored in the feedback we and others have provided in submissions. We were troubled, for example, by the May 2022 FTR consultation which, unsurprisingly, was not well received by most stakeholders.[7]

There have also been unexplained inconsistencies in the views the Authority has expressed.[8]

For example, the May 2022 FTR consultation contradicted the Authority's 2020 post-implementation review and 2021 commentary on the topic without explanation. The Authority also appears to simultaneously hold the view that there is "evidence to suggest that prices may not have been determined in a competitive environment" (October 2021, WMR) and there has been a "persistence of high spot and forward prices, well above the cost of new renewable supply" (October 2022, WMR) yet "outcomes in the spot and hedge markets are consistent with a healthy and efficient market to the long-term benefit of consumers" (May 2022).[9]

[6] Economic Development, Science and Innovation Committee, 2020/21 Annual Review of the Electricity Authority Responses to written questions 1–157, Response provided: 3 February 2022.
[7] Genesis and Meridian were the only submitters that provided supportive submissions, but this reflected that the views the Authority expressed mirrored views they had both previously expressed to the Authority.
[8] A point made by various submitters in response to the August 2022 SRAM consultation.
[9] Electricity Authority, Re: Flick Electric submission to the Petitions Committee on market pricing and vertical-integration in the electricity market, 27 May 2022.

Consumer-centricity = consumer benefits ≠ consumer + supplier benefits

We feel the Authority's ambitions necessitate a shift from the current neutrality between consumer benefits and supplier benefits[10] to a consumer-centric focus. The review of the Authority's interpretation of its statutory objective was put on hold but should be reinstated.

We reiterate "For a consumer it makes no difference whether an improvement in competition reduces prices due to cost efficiency or reduction of monopoly rents. A dollar is a dollar is a dollar".[11]

The Authority's pure efficiency focus has meant the full benefits of competition – which include the benefits to consumers of lower, more competitive prices – are not taken into account which locks in a bias against pro-competitive market reforms. Efficiency is not an end in itself.

The Authority's Consumer Care Guidelines also highlight problems with a pure economic efficiency perspective. Providing consumer protection – including the extended process before disconnection can occur and restrictions on disconnection of vacant sites – goes well beyond what would be considered economically efficient. Core aspects of the Consumer Care Guidelines are likely inconsistent with a pure efficiency criterion.[12]

We do not consider it desirable or conducive to regulatory certainty that the electricity industry is operating under dual interpretations of "long-term benefit of consumers" with the Authority[13] taking an efficiency-only approach and the Commerce Commission[14] taking into account both efficiency and wealth transfer (price) benefits.

Ensuring the regulatory regime is fit-for-purpose and reforms can address the underlying structural problems in the market

The consultation references the Authority's SoI including the intention to "provide a stable regulatory regime". The consultation also references that "the Authority has historically been resourced for incremental change <u>as opposed to the structural changes and major regulatory reform that are needed now, and in the future</u>" [emphasis added] and "transformational changes [are] needed to support particularly the transition to a net zero emissions economy by 2050".

We have commented previously about the risks of a regulatory strategy based on a desire for "a stable regulatory regime".[15]

Care is needed to ensure stability doesn't mean a status quo bias and is not a roadblock against needed regulatory reforms or the promotion of competition (including "thriving competition") for the long-term benefit of consumers.

"Regulatory stability" does not, for example, provide a "steady environment for investment" if underlying market failures are not addressed and/or the regulatory environment favours or

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[10] The Authority's 2022 SRAM consultation proposals would result in in significant (negative) wealth transfers from consumers to incumbent generators.
[11] Electric Kiwi, Flick Electric, Pulse and Vocus, The Authority has provided robust evidence of fundamental, structural problems in the wholesale market, 17 December 2021, "Regulatory incrementalism won't resolve fundamental structural problems or deliver a high performing market" at: https://www.ea.govt.nz/assets/dms-assets/29/Independent-retailers-submission.pdf.
[12] Ecotricity, Electric Kiwi, Flick Electric, and Vocus, Independent retailers support introduction of new Consumer Care Guidelines, 27 November 2020: https://www.ea.govt.nz/assets/dms-assets/27/Independent-Retailers-submissions.pdf
[13] Section 15 of the Electricity Industry Act.
[14] Section 52, Part 4 of the Commerce Act.
[15] Refer, for example, to: Electric Kiwi, Flick Electric, Pulse and Vocus, The Authority has provided robust evidence of fundamental, structural problems in the wholesale market, 17 December 2021, "Regulatory incrementalism won't resolve fundamental structural problems or deliver a high performing market" at: https://www.ea.govt.nz/assets/dms-assets/29/Independent-retailers-submission.pdf.

entrenches incumbent operators at the expense of investment by new entrant or independent operators. There are plenty of examples of 'stable' regulatory regimes which were subsequently displaced because they did not deliver the outcomes they should have. A New Zealand example being telecommunications in the 2000s where the Government had to step in and over-ride Commerce Commission decisions.

The Authority should consult on its annual work programme in conjunction with appropriations

The Authority's funding needs are a function of the work it intends to do and when the work will be done. It would be helpful to understand how the budget will impact the work programme and key milestones so it is clearer what would be delivered with any extra funding. At present, it appears resolving the high (and increasing) staff turnover problem, which has emerged over the last 3-years, is more important for project delivery than budget.

We agree with the Authority that it is desirable to consult on the work programme "because respondent views are valuable and inform the further development of the work programme".[16]

The Authority's 2020/21 appropriations consultation did not include consultation on its indicative work programme because the Authority was "embarking on a new strategy development process, described below, to reset the Authority's current strategy" and planned to "engage with stakeholders during the strategy development process".[17] However, the work programme consultation has now fallen by the way-side, along with its Consultation Calendar, and has not been reinstated.

We note the GIC holds industry forums to commence development of its SoI and to establish its work programme and work programme costs.[18]

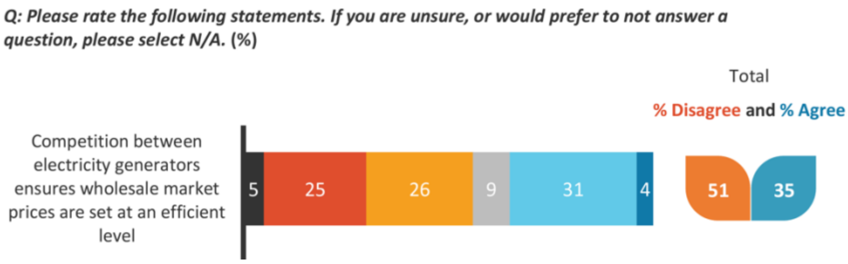
There should be a clear line-of-sight between the Authority's strategic ambitions, work programme and funding request

It is important that there is a clear line-of-sight between the Authority's statutory objective, strategic ambititions, gap analysis (identification of problems in the market), work programme and funding request.

The Authority's WMR provides a good example of this. The Authority's perception survey shows the majority of market participants (increased if incumbent gentailer interests are excluded) have concerns that competition between electricity generators does not ensure wholesale market prices are set at an efficient level. The WMR has confirmed this perception has sound basis.

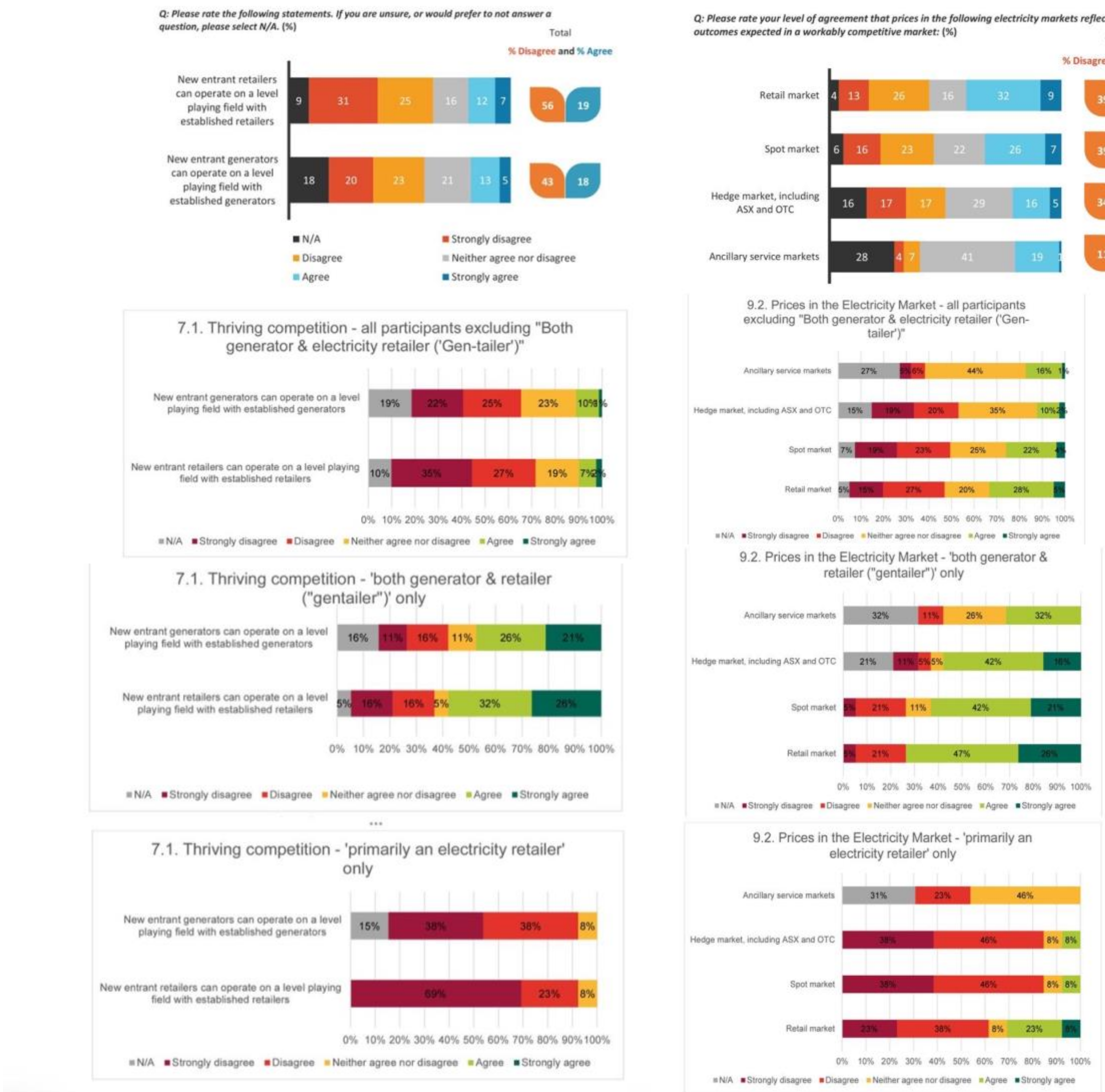
[16] Electricity Authority, Summary of Submissions and Authority Responses: 2019/20 Levy- funded appropriations and indicative work programme", 19 February 2019.
[17] Electricity Authority, 2020/21 LEVY-FUNDED APPROPRIATIONS, 5 November 2019.
[18] https://www.gasindustry.co.nz/assets/DMS/About-/News-Publications/News-/News-Bulletin-19-October-2022/News-Bulletin-19-October-2022.pdf

The work the Authority is undertaking on the WMR is something we had been championing for some time and was a major gap in the EPR work that the Authority is now filling.



The survey also highlighted substantial concerns about competition in the retail market which need to be addressed.

The following extracts from the SOI survey, for example, highlights 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 drops to just 9% of market participants agreeing there is a level playing field. These results reinforce the need for a focus on identifying (and eliminating) barriers to (retail) competition, in tandem with the WMR, and there is a long way to go for “ensuring a level playing field”.



The Authority has both acknowledged "that the retail market is highly concentrated",[19] which is well supported by market evidence, but also claimed "There is clear evidence of thriving competition in the retail market".[20] It seems apparent there is a wide gap in perceptions between the vast majority of stakeholders and the Authority about how well the retail market is performing which is hampering the work programme.

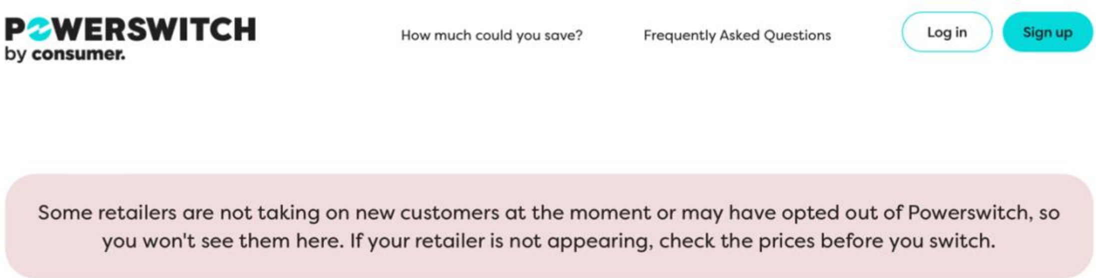
The Authority should undertake a review of the performance and accuracy of Powerswitch

We consider that a review of the performance and accuracy of Powerswitch should be undertaken in 2022/23. Given: (i) the Authority's levy-funding of Powerswitch; and (ii) regulation requiring retailers to promote Powerswitch to their customers, it is important the Authority ensures it is fit-for-purpose and safe to rely on by consumers deciding whether to switch. Based on current settings there is likely to be a high incidence of false-negatives with consumers directed to a more expensive retailer or tariff.

In 2020 we submitted that: "We consider the arrangements for Powerswitch should be revisited … We would like consideration to be given to whether the price comparison service should be competitively tendered, and of the scope to monitor the accuracy and compliance with key objectives of the information provided by the service".[21] Our concerns about Powerswitch have grown since then.

Powerswitch does not provide a comprehensive model, does not support innovative pricing and bundling propositions, and does not have a road map to do so. We do not presently have confidence it can be relied on to accurately determine the lowest cost supplier.

Some of the issues with the Powerswitch website have resulted in the following qualification being added but this doesn't provide a full and accurate picture of why all retailers do not appear on the site. We question whether Powerswitch can be genuinely described as "independent" when inclusion on the site is funding contingent.



The Authority should review the current funding arrangements for Powerswitch

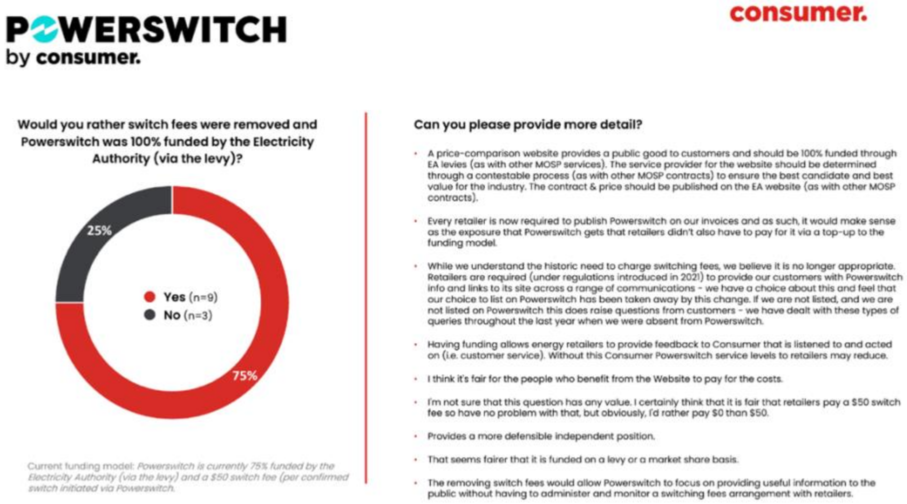
It is not clear that Powerswitch requires more funding than provided by the Authority or what service requirements the Authority and Consumer NZ agreed would be provided from the funding. It is also unclear why a hybrid levy:retail sales commission funding model would be desirable. We consider the funding arrangements should be reviewed and consulted on. The requirement to

[19] Electricity Authority, Saves and Win-backs Code Amendment, 5 November 2019, paragraph 2.19.
[20] Electricity Authority, Re: Flick Electric submission to the Petitions Committee on market pricing and vertical-integration in the electricity market, 27 May 2022.
[21] https://www.ea.govt.nz/assets/dms-assets/28/Independent-retailers-submission-202122-Levy-funded-appropriation.pdf

promote the site regardless of whether you are represented on it provides Consumer NZ a pseudo monopoly status when it comes to setting fees.

The way Consumer NZ chooses to set Powerswitch fees – on a retail sales commission basis – is a barrier to and 'tax on competition' which favours incumbent retailers at the expense of small and new entrant retailers. We consider that Powerswitch should be fully levy-funded.

Our request for a review of Powerswitch funding is supported by ConsumerNZ survey results e.g.:[22]



Concluding remarks

The independent retailers want to help the Authority succeed in its strategic ambititions.

A focus of ours has been to support and encourage the Authority to develop and enhance market settings to ensure they are robust and the delivery of long-term benefits to consumers. We have made sure our feedback is constructive with a focus on what we see as the pathway to success for the Authority and the electricity industry.

What the Authority sees through the lense of economic efficiency, consumers see in terms of well-being and 'dollars in the back-pocket', and the independent retailers presently in terms of existential threat. We urge the Authority to prioritise its strategic ambition of "thriving competition" which requires the present barriers to competition and high levels of market concentration in both the wholesale and retail markets are eliminated.

[22] Consumer NZ, CNZ Funding of Powerswitch Feedback - Summary 06.09.22.

Yours sincerely,

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