

11 July 2017

Submissions
Electricity Authority
PO Box 10 041
Wellington

By email: submissions@ea.govt.nz

Dear Carl,

Re: Enabling Mass Participation Issues Paper

Pioneer Energy (Pioneer) welcomes the opportunity to make submissions on the Issues Paper regarding enabling mass participation publishing by the Electricity Authority (Authority) on 30 May 2017.

Context for Regulatory Change

The Issues paper calls for suggestions about changes to the regulatory system that may be needed for consumers to benefit from the changes in technology and innovation happening now in the electricity industry, in particular mass participation.

The government has recently updated its expectations of any regulatory system¹. Pioneer has found these expectations to be a useful guide in preparing this submission – refer Schedule 1.

Any substantive changes to regulations will need to meet these expectations. In particular, there should be very clear objectives. For example, are changes to enable mass participation required to:

- cope with technology and innovation that is happening now?
- futureproof the Code for developments that are as yet unknown?
- encourage more involvement by end consumers?
- protect existing players working within the current Code?

In our view, the existing wholesale electricity market is far too complex and regulated to accommodate mass consumers. Some fundamental changes would be required to achieve mass participation.

With reference to the government's expectations, our main question is:

What is a "proportionate, fair and equitable" response by the electricity industry regulator charged with achieving long-term benefits for consumers?

¹ See: <http://www.treasury.govt.nz/regulation/expectations> Updated April 2017

This is a much broader question than we feel has been addressed in the Authority's Issues paper. It is also a question that may be wider than is contemplated by the Authority's current mandate. We have reviewed how similar issues have been addressed in other countries.

The Australian Energy Market Commission (AEMC) is considering essentially the same topic² in a draft paper released since the Authority published its Issues paper. AEMC consulted on an 'approaches' paper issued in December 2016. From this consultation the Commission has identified principles of good market design³, namely:

1. facilitate effective consumer choice
2. promote competition
3. promote price signals that encourage efficient investment and operational decisions
4. enable technology neutrality
5. prefer simplicity and transparency
6. regulate to safeguard the safe, secure and reliable supply of energy, or where it would address a market failure

Does the Authority have a similar set of market design principles that are guiding this review of the regulatory system?

Market and Regulatory Complexity

The focus of the Issues paper is on how to ensure / allow consumers to participate in the market. Our question is: What does "participate" mean and what is the "market"?

Our experience is that the existing rules and market arrangements are very complex. It is hard and expensive for a company that wants to enter/participate in the electricity retail market to establish compliant systems and fund retail activity – let alone a consumer being required to meet the same obligations.

The Issues paper is not clear about what the core constructs of the sector, 'market' or Code are that are not negotiable. For example, is it essential that all physical electricity volumes are transacted through the gross pool – on the generation and retail sides of the ledger – to enable reconciliation and payment?

Pioneer has recommended in past submissions that the first and highest priority in the Authority work programme should be to:

- resolve current barriers for new entrants in the wholesale and retail markets; and
- simplify the Code

as this will create benefits for all existing players and any new entrants.

The Authority claims the retail electricity market is already benefiting from strong competition. Paragraph 3.4 states *"Consumers in some regions of the country can now choose from more than 20 retailers, compared to eight in 2004."*

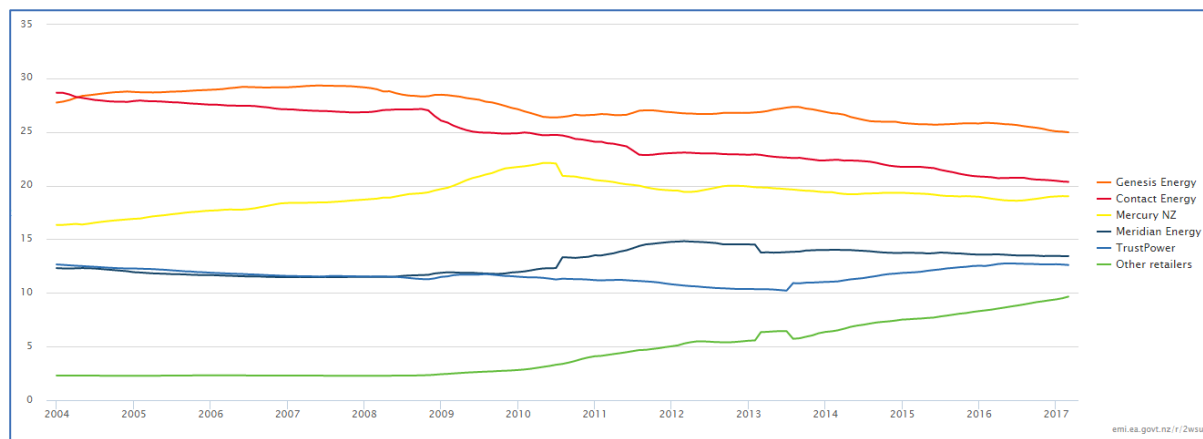
The following graph shows the change in electricity retailer market shares since 2004. Over this time the market share of the five large VI gentailers has changed

² See: <http://www.aemc.gov.au/Markets-Reviews-Advice/Distribution-Market-Model>

³ These principles are described in more detail on page 26-27 of the Draft report See: <http://www.aemc.gov.au/getattachment/25e63b7d-8c28-441b-b315-2d438f285d81/Draft-report.aspx>

from 97.70% to 90.35%, or a decline of 7.35% of total customer connection points over 13 years⁴.

While there may be 30 retailers, 25 of these are sharing just 7.35% of the total ICPs amongst themselves. This is about 154,000 customers or an average of 6,100 customers for each retailer!. We query whether this is truly a successful and competitive market.



The current barriers for new entrants arising due to the vertical integration of incumbent market participants include:

- a lack of correlation between spot market prices and seasonal demand, providing an advantage to vertically integrated gentailers in the commercial tender market;
- poor liquidity (by international standards) in the financial contracts markets despite more than 15 years of market reforms promoting wholesale market competition;
- pricing of Fixed Price, Variable Volume CFD and Retail TOU contracts below the prevailing ASX Fixed Price, Fixed Volume price; and
- failure of the Save Protection Scheme to protect new entrant retailers (or opt-in retailers) from predatory market behaviours.

A proportionate, fair and equitable regulatory response by the Authority would be for these existing competition issues to be resolved for the current 25+ new entrant participants before creating further 'retail market noise' which will mask the wholesale market barriers.

Wholesale versus distribution 'markets'

The electricity power system is an engineering system. Central co-ordination is required to match instantaneous demand with supply by dispatching grid connected generation. The current Code and market regulations have been designed to manage this real-time system, not to facilitate mass consumer participation. The wholesale market facilitates competition in electricity generation. As described in the

⁴ EMI website from 1 January 2004 to 28 February 2017

http://www.emi.ea.govt.nz/Reports/VisualChart?reportName=R_MST_C&categoryName=Retail&reportGroupIndex=2&eventMode=Async&reportDisplayContext=Gallery#RegionType=NZ&RegionCode=NZ&ParentCompany=Y&Grouping=T5&MarketSegment=All&Percent=Y&DateFrom=01/01/2004&DateTo=28/02/2017&reportName=R_MST_C&condensedView=false

AEMC report⁵ “[NEM] decentralised operational and investment decisions in generation to commercial parties who have stronger incentives to make efficient decisions and are better placed to manage the risks of those decisions” – the NZEM is the same. Maintaining this centralised dispatch is important – it may become the balancing item to ensure secure and reliable supply.

By definition consumer choice happens at the distribution network level where the consumer is physically connected to the current electricity system. New technologies are enabling consumers to manage the supply and use of their own electricity at this connection point. The AEMC report focuses on creating a competitive market for distributed energy resources at the distribution level. Pioneer suggests this is an appropriate starting point for the Authority. Existing and new distributed generation does and can offer valuable products and services to their immediate neighbour in the supply chain – the distributors – resulting in an overall improvement in the efficiency of the overall system. The AEMC notes:

“Consumers will drive where distributed energy resources are installed, and how they are operated, since consumers are generally in the best position to decide what works for them.”⁶

Energy market arrangements should enable consumers to monetise as many of these potential sources of revenue as possible, in accordance with their own interest. In the Commission’s view, the best way to achieve this is to develop energy market arrangements that promote consumer choice, while providing a level playing field for market participants.”⁷

Our recommendation is mass participation objectives should be aimed at encouraging more involvement by end consumers, and that any regulation and/or Code changes initially be addressed in the distribution market segment

The ‘distribution’ market is going to become more ‘competitive’. Consumers, or mass participation, may become so prevalent and competitive that no regulation is required other than the generic competition and fair trading laws. Policy decisions need to be made about the regulatory regime for distribution companies. This is beyond the mandate of the Authority but Pioneer understands it may be under consideration by MBIE.

Pioneer’s principle concern is to ensure the regulatory system ensures a level playing field for activities (existing or new) that provide the same products and services. We would welcome the opportunity to discuss this submission with you.

Yours truly



Fraser Jonker

CEO

Pioneer Energy Ltd

⁵ Ibid, see discussion of NEM on page 21-22

⁶ Ibid, page 32

⁷ Ibid, page 33

Schedule 1: Government Regulatory Expectations

In relation to these Expectations, the following definitions are used:

- a regulatory system is a set of formal and informal rules, norms and sanctions, given effect through the actions and practices of designated actors, that work together to shape people's behaviour or interactions in pursuit of a broad goal or outcome
- a regulated party is a person or organisation that is subject to behavioural expectations, obligations and/or sanctions within a regulatory system.

The following is a copy of the section on Government's expectations.

"The government expects any regulatory system to be an asset for New Zealanders, not a liability.

By that we mean a regulatory system should deliver, over time, a stream of benefits or positive outcomes in excess of its costs or negative outcomes. We should not introduce a new regulatory system or system component unless we are satisfied it will deliver net benefits for New Zealanders. Similarly, we should seek to remove or redesign an existing regulatory system or system component if it is no longer delivering obvious net benefits.

The government believes that durable outcomes of real value to New Zealanders are more likely when a regulatory system:

- *has clear objectives*
- *seeks to achieve those objectives in a least cost way, and with the least adverse impact on market competition, property rights, and individual autonomy and responsibility*
- *is flexible enough to allow regulators to adapt their regulatory approach to the attitudes and needs of different regulated parties, and to allow those parties to adopt efficient or innovative approaches to meeting their regulatory obligations*
- *has processes that produce predictable and consistent outcomes for regulated parties across time and place*
- *is proportionate, fair and equitable in the way it treats regulated parties*
- *is consistent with relevant international standards and practices to maximise the benefits from trade and from cross border flows of people, capital and ideas (except when this would compromise important domestic objectives and values)*
- *is well-aligned with existing requirements in related or supporting regulatory systems through minimising unintended gaps or overlaps and inconsistent or duplicative requirements*
- *conforms to established legal and constitutional principles and supports compliance with New Zealand's international and Treaty of Waitangi obligations*
- *sets out legal obligations and regulator expectations and practices in ways that are easy to find, easy to navigate, and clear and easy to understand, and*
- *has scope to evolve in response to changing circumstances or new information on the regulatory system's performance. "*

Schedule 2: Response to specific Consultation Questions

Q2. What is your view of the opportunities to promote competition and more participation in the electricity industry?

As discussed in the cover letter, Pioneer has concerns about the current level of competition arising from the existing industry structure and Code.

In summary,

- In our view, the incumbent VI Gentailers can, and do, price FPVV contracts below the ASX benchmark. VI Gentailers can, on an ongoing basis, price FPVV contracts below the ASX benchmark because they have both a generation margin (notionally ASX less spot or OTC /internal transfer less spot) and a retail margin (notionally retail less ASX /internal transfer). Consequently even at less than ASX they will have positive (generally) gross cash margins.

This does not apply to an entity that is dependent on the ASX. Pure independent retailers do not, obviously, have this choice.

The ongoing dominance of the incumbent VI Gentailers is stymying competition. Changes to achieve greater liquidity in the hedge markets would also assist new entrant independent retailers to better manage risk.

- The Save Protection Scheme is not achieving the objectives of the Authority as outlined when the Scheme was implemented. Our letter provides real information and examples that dispel all the qualitative benefits anticipated by the Authority. One of the major gentailers is recording about 40% of its customers that initiate a switch are withdrawing that switch request – ie are being won-back. The original consultation paper on the save protection scheme included a sensitivity analysis on the profitability of a customer acquisition campaign – the assumed 20% win-back rate wiped out any gains from the campaign – and submitters suggested this 20% assumption was too high.

The Authority's Compliance team came to the same view that the save protection scheme is ineffective in its decision not to progress the breach of Bosco. We strongly recommend the Authority add to its 2017/18 work programme a change to the Code to place a moratorium on win-backs for 30-60 days after a switch is processed to allow the gaining retailer to complete the on-boarding of the customer.

Q3. What other issues might inhibit efficient mass participation? Please provide your reasons.

We acknowledge the five areas the Authority has identified. We refer you to our answer to question 2 which details two additional areas we submit the Authority should address as soon as practicable.

Q15. Would the functioning of the market for hedges and PPAs and the availability of finance be improved if there were greater transparency of long-term prices and greater standardisation of terms and conditions for long-term contracts?

The Authority has focused on facilitating the emergence of virtual power stations, new generation or demand response in this section of the Issues paper. However, a competitive and well functioning market for hedges and PPAs is equally important for new entrant retailers.

Our view is that the more transparency there is about future prices the more informed and efficient the electricity market would be – both generation and retail. The hedge market disclosure website compliments the ASX as it provides information about pricing of other products used to manage risk, ie, FPVV contracts and OTC contracts. While complying with the hedge disclosure requirements may be more onerous for the main 4-5 gentailers this group also dominates determination of the prices for these contracts.

New entrant generators and retailers would be placed at a disadvantage if a future price curve for FPVV and OTC contracts was not available.