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Submissions
Electricity Authority
Wellington

By e-mail: WholesaleConsultation@ea.govt.nz, retaildata@ea.govt.nz

The independent retailers support improvements to hedge disclosure and market monitoring

2degrees, Electric Kiwi, Flick Electric and Pulse Energy (the independent retailers) support publication of better quality information about the operation and performance of the electricity market, including improved hedge disclosure obligations (HDOs) and market monitoring.

We have responded to the consultation papers on HDOs and retail market monitoring with this one submission reflecting the symbiotic relation between problems in the hedge market and how they manifest in adverse, downstream, retail market outcomes.

Large potential benefits could be released through establishment of a more competitive market

We welcome the Authority's recent commentary that one of its policy objectives is to "Maximise the benefits of competition in electricity supply for consumers".¹ We also agree with the Authority that even "a small improvement in retail competition ... is likely to have material benefits to consumers." The corollary is that deterioration in the competitiveness of the electricity market is likely to have material detriments for consumers.

Our submissions on the Authority's 2024/25 appropriations consultation,² and in response to the MBIE Energy Transition consultation³ last year, detailed clear evidence of the fragile and vulnerable state of retail competition and that, based on reasonable and objective metrics, the strength of competition in the electricity retail market has gone backwards; particularly over the last two years.⁴

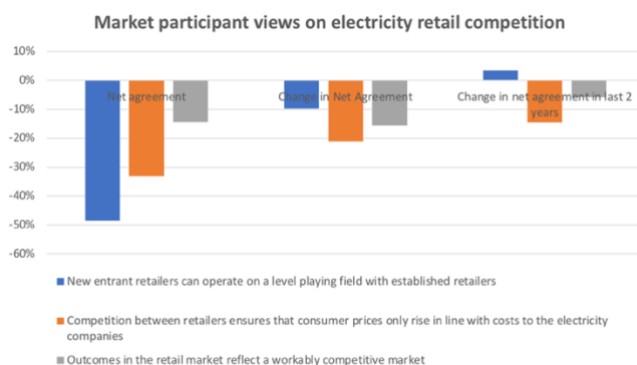
¹ Electricity Authority, Options to support consumer plan comparison and switching, consultation paper, 1 February 2024.

² 2degrees, Electric Kiwi, Flick Electric and Pulse Energy, 2024/25 levy-funded appropriations consultation – priority should be given to promotion of stronger, thriving competition, 26 January 2024.

³ 2degrees, Electric Kiwi, Flick Electric and Pulse Energy, submission to MBIE on Energy Transition omnibus, Stronger competition is key to affordable electricity and a successful energy transition, 3 November 2023.

⁴ We have detailed these concerns extensively in submissions to the Authority and, most recently, provided updated evidence of the problems in submission to MBIE in response to the Energy Transition omnibus. We have provided the Authority with a copy of our (as yet unpublished) MBIE Energy Transition submission.

The Authority’s market participant surveys paint a poor picture of the state of the electricity retail market competition:⁵



Summary of the independent retailers’ views

- We support enhanced information disclosure and market monitoring:** We agree with Electric Kiwi and Haast that “The best way to ensure provision of high quality information is to ensure: (i) there are clearly defined information requirements; and (ii) the information is provided as part of regular reporting/disclosure rather than ad hoc information requests or demands.”⁶ Our submission on the Authority’s 2024/25 appropriations provides support for increased funding for market monitoring and compliance enforcement.⁷
- There is a need for mandatory reporting on and monitoring of financial/contract market activity:** This market needs monitoring far more than retail. As independent retailers are becoming increasingly reliant on over-the-counter (OTC) hedging contracts, increasing transparency in the OTC market will be essential. We agree the HDOs are out-of-date⁸ and support the Authority’s proposed HDO reforms. Where the Authority’s proposals conflict with MDAG’s recommendation 2 (see bullet below) we support MDAG’s view on the matter.⁹
- The Authority should use internationally recognised competition tests as part of its market monitoring:** We continue to advocate the Authority use benchmarks (based on actual/achievable/real world) of hedge prices available to independent retailers – for price squeeze, non-discrimination, and equivalence of input type testing.
- Enhanced stress testing could be useful for helping highlight problems with access to hedge contracts/risks management tools:** Retailer financial stress monitoring does not reflect how independent retailers fail and are failing – the problem is long-term margin erosion, not singular wholesale stress events.¹⁰

⁵ Net agreement = strong agreement + agreement – strong disagreement – disagreement.

⁶ <https://www.ea.govt.nz/documents/1496/Haast--Electric-Kiwi-submission-Improving-the-framework-for-the-EAs-information.pdf>

⁷ Refer to the section “We continue to support additional funding for monitoring and compliance enforcement”.

⁸ https://www.ea.govt.nz/documents/3781/Independent_Retailers.pdf

⁹ MDAG, Price discovery in a renewables-based electricity system, FINAL RECOMMENDATIONS PAPER, 11 December 2023.

¹⁰ MDAG has made similar comments: MDAG, Price discovery in a renewables-based electricity system, FINAL RECOMMENDATIONS PAPER, 11 December 2023, paragraphs C.28-C.39.

Genesis,¹¹ Meridian¹² and MEUG¹³ have each suggested the Authority hasn't been clear about the purpose of stress testing –introduced in response to COVID. MDAG posited that stress testing can be used “to reinforce participants’ incentives to actively manage their exposure to spot price risk”.¹⁴ For the avoidance of doubt, the problem is not a demand-side problem, it is a supply side problem i.e. problems with access to adequate hedge contracts for independent retailers to manage their exposure to spot price risk.¹⁵

We consider it would be useful for the Authority to analyse historic margin/stress test data to see how this is changing and why.

- **Information disclosure does not reduce market power:** Information disclosure is not a substitute for regulating against the (ab)use of significant or substantial market power. **While we support enhanced information disclosure, regulation of access to hedge products is far more important.** We consider MDAG’s market-making for flexibility products recommendation 24 should be treated as the Authority’s single most important priority and implemented as part of Recommendation 8 in calendar 2024 (and not a tranche 2 action “contingent on assessing whether previous measures are sufficiently effective”).¹⁶
- **Voluntary information disclosure is unlikely to be fully effective:** The Authority has stated “... we are not proposing to mandate disclosure of request for proposal (RFP) including bids and offers, instead relying on the voluntary sharing of such information, in alignment with the Voluntary Code of Conduct developed by the OTC Electricity Market Working Group”. The Code of Conduct includes no such requirement, but we understand this commentary reflects that the signatories have agreed to disclose their information on the OTC market including RFPs upon the Authority’s request and that they can proactively pass on responses to RFPs to the Authority.

It is unclear that any party (i.e. the incumbent gentailers) that strongly opposes mandatory disclosure, including on the basis of compliance costs, would voluntarily disclose the same information, which is reflective that only independent retailers have chosen to be a disclosing party under this informal regime.

We support MDAG’s recommendation: “enhanced disclosure should include information on contract offers and bids, as well as executed contracts” (part of Recommendation 2).¹⁷

- **Information needs to be disclosed and published in a timely manner:** We agree with MDAG “Public information is also essential. It must be neutral, clear, timely and relevant for consumers

¹¹ e.g. “Genesis has, despite proactively enquiring on several occasions over the past two years, seen no evidence of how the information gathered under the rolling s46 requests to date has been used.” <https://www.ea.govt.nz/documents/1508/Genesis-submission.pdf>

¹² e.g. “The Authority’s role is to protect and promote competition as a process, but not individual competitors. ... The Authority has not explained how the present circumstances justify the proposed monitoring of retailer distress.” <https://www.ea.govt.nz/documents/1509/Meridian-submission.pdf>

¹³ e.g. “Missing ... is an explanation of what policy problem the proposed continuous disclosure is addressing.” <https://www.ea.govt.nz/documents/1510/MEUG-to-EA-Retailer-financial-stress-data-request-consultation-23-Aug-22.pdf>

¹⁴ MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

¹⁵ MDAG has raised two concerns about ‘demand-side’ problems:

- Consistent with the Meridian submission referenced above, the prospect of “Accidental inattention” and that “participants may accidentally take on more spot price risk exposure than they intended” is an issue for shareholders and not the industry regulator.
- The history of regulatory intervention in spot price setting in the wholesale electricity market provides only one example where an industry participant (Mercury) was able to successfully get the regulator to intervene (26 March 2011 UTS) to bail them out of their spot exposure position. This would indicate moral hazard is an implausible, theoretical risk. It may have been a legitimate concern in the 1990s when the wholesale market was being established but it isn’t now.

¹⁶ MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

¹⁷ MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

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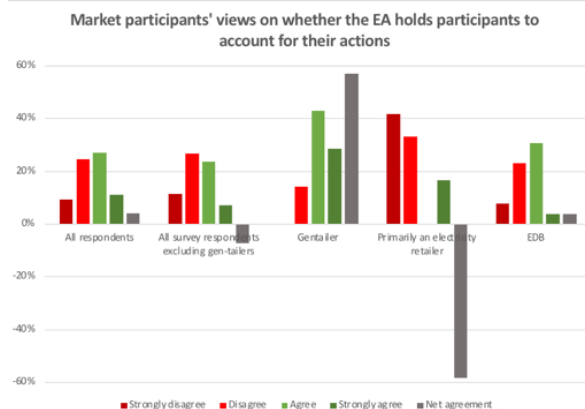
If information disclosure and market monitoring is going to be useful, there needs to be timely use and publication of the data. The gross margin data for the 2022 financial year wasn't released until the end of May 2023 and the ITP data the end of June 2023.^{19,20}

- **Retail monitoring can be enhanced to tie in with the issues the Authority has raised in relation to consumer switching.**²¹ The Authority has raised important issues about customer stickiness (many incumbent retailer customers have never switched and many consumers, particularly low income and vulnerable consumers, are paying a 'loyalty tax') in its consumer switching consultation. We consider that it would be useful to extend EMI consumer switching data to include the extent some consumers are 'sticky' and about the 'loyalty tax' they paid e.g. re-introduce the "consumer savings" monitoring which ceased from 2017 but with modification/enhancement to improve accuracy.²²
- **There is some low hanging-fruit e.g.:**
 - all the incumbent gentailers are public entities and, therefore, there is plenty of information that is publicly available which the Authority could use/analyse for monitoring purposes; and
 - the Authority Board agreed in September 2020 that wholesale market concentration statistics would be added to EMI²³ but this is yet to happen.

Market monitoring needs to be undertaken without fear or favour

It is important market monitoring and compliance enforcement is undertaken without fear or favour, and the Authority is seen to be holding market participants to account for their conduct.

The Authority shouldn't be happy with market participant perceptions of the extent to which it holds participants to account. The only positive results are from the gentailers which probably is indicative that other market participants' concerns are based on gentailer behaviour.



¹⁸ MDAG, Price discovery in a renewables-based electricity system FINAL RECOMMENDATIONS PAPER, 11 December 2023.

¹⁹ There have been similar issues with the Consumer Care disclosures.

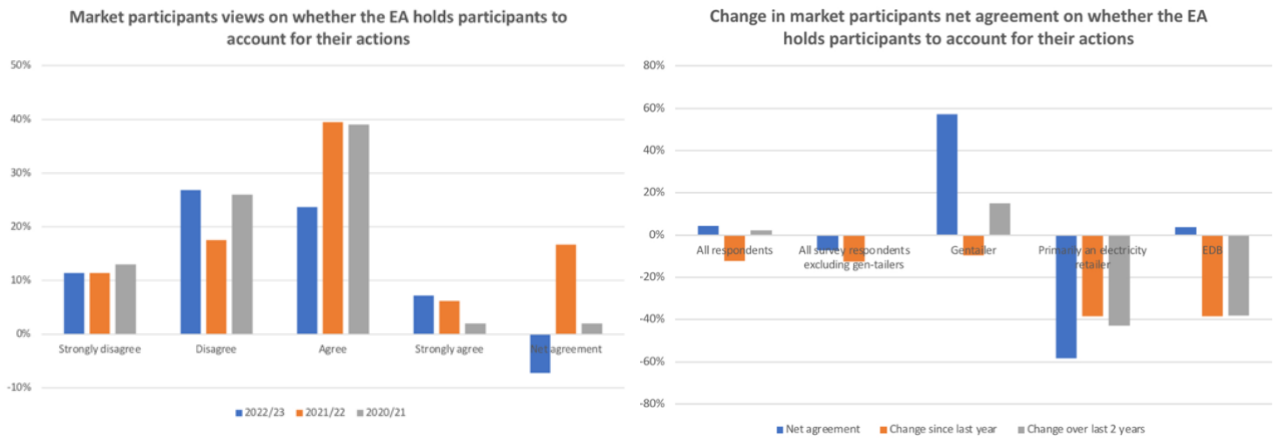
²⁰ Nova raised similar concerns in relation to stress testing disclosures e.g. "Market participants only get to see the Authority's results from this date 6-months and more in arrears, and don't really gain any insights due to the lack of timeliness or definition." Reference: <https://www.ea.govt.nz/documents/1511/Nova-submission.pdf>.

²¹ <https://www.ea.govt.nz/projects/all/improving-retail-market-monitoring/consultation/improving-retail-market-monitoring-clause-216-information-notice/>

²² The Electricity Price Review analysis of consumer savings/loyalty taxes indicates the Authority's calculations substantially understated their size.

²³ https://www.ea.govt.nz/documents/1409/Hedge_Market_Enhancements_Securing_access_to_exchnage_date_-_decision_paper.pdf

Likewise, it is notable market participant perceptions about how well the Authority holds participants to account has dramatically fallen away in the last year, across all market participant categories, including gentailers.

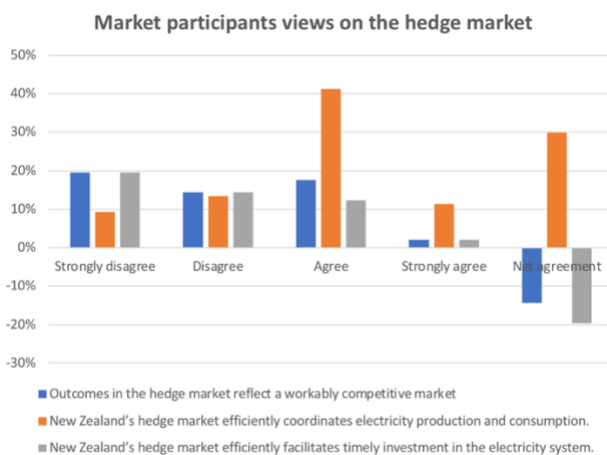


At times, the Authority has done a good job of highlighting serious market/conduct problems such as in the wholesale market review but shied away from reform that would address the issues it identified (with the exception of the ‘Tiwai’ non-discrimination rules). At other times, we have felt the Authority’s defence of incumbent practices has been inappropriate – the defence of incumbent fixed price variable volume (FPVV) discrimination and ITP disclosures being cases in point.

Enhanced monitoring of financial markets is needed

Access to exchange-traded and OTC hedging contracts is critical to enable independent retailers and generators to manage their exposure to price and volume risk. As independent retailers are becoming increasingly reliant on OTC hedging contracts, increasing transparency in the OTC market will be essential. Independent generators can play a key role in improving competitive supply of electricity but quality public information on a long-term price path is first needed to successfully fund any investment. We agree the HDOs are out-of-date and not fit-for-purpose,²⁴ and support the Authority’s produced hedge disclosure obligation reforms. MDAG has done a good job of articulating the criticality of access to risk management products.

Market participant survey results highlight a lack of confidence that hedge prices are competitively set and in the ability of the hedge market to facilitate investment, including the investment required for the energy transition.



²⁴ https://www.ea.govt.nz/documents/3781/Independent_Retailers.pdf

It is important to understand the problems in the financial/hedge contract markets are only partly an issue with imperfect information/information asymmetries and principally an issue of market power coupled with vertical-integration.

It is not sufficient to “enhanc[e] transparency through broader information collection and publication on OTC contracts” in order “to increase market confidence and promote competition in, and efficient operation of, the electricity industry for the long-term benefit of consumers”.²⁵ Independent retailers also need access to hedge contracts on a non-discriminatory basis in order to compete on a level-playing field.

Likewise, it is only correct that “Active monitoring of the retail market ensures industry participants are accountable” if monitoring is combined with robust enforcement and policy reforms where problems are identified. The Authority’s monitoring of ITPs is an example where we consider there to be clear problems with incumbent gentailers’ behaviour but they have not been held “accountable” and the Authority has actually defended conduct that is harmful to retail competition (see discussion below under “Internal transfer payment and segmented profitability reporting”).

Internal transfer payment and segmented profitability reporting should be enhanced

Our submission on the 2024/25 appropriations canvasses work we consider the Authority should do to improve internal transfer price and segmented profitability reporting relevant to the disclosure and monitoring consultations.²⁶

We remain of the view that the Authority should fully implement the Electricity Price Review retail-wholesale financial separation recommendation. The incumbent gentailer financial statements provide strong prima facie evidence that they are using their electricity wholesale businesses to cross-subsidise their electricity retail businesses but introduction of financial disclosure requirements for electricity wholesale and retail would provide more definitive information.

This would provide better and more useful information than that from the Authority’s intention to “Compar[e] pricing and plan data against wholesale and spot market data across retailers [to] enable us to better monitor retailers’ retail margins ... for the purposes of monitoring competition.”

We agree with Ben Hamlin, in advice to the Energy Hardship Expert Panel, that:²⁷

“The Electricity Authority, or government, should prioritise further consideration of regulatory requirements designed to directly address the barrier to entry posed by vertical integration.

“This would likely take the form, at least initially, of requiring some degree of accounting separation of the generation and retail business units of vertically integrated firms, so that the costs, revenues and profits of each business unit, and any transfers between them, can be clearly identified.”

There is plenty of international precedent, including in the United Kingdom, for how to adopt full financial separation and disclosure.

We also remain concerned that the efficacy of the Authority’s ITP monitoring is undermined by the use of unrealistic and inappropriately low benchmarks. We discussed this point in response to

²⁵ We have the same views about claims such as that “... publishing more information and insights on OTC contracts would increase confidence in the price information and, by extension, market competitiveness.”

²⁶ Refer to the section “ITP and segmented profitability reporting should be enhanced”.

²⁷ Ben Hamlin, Barrister, Advice to Energy Hardship Expert Panel, 16 June 2023.

MBIE's Energy Transition omnibus consultation. The submissions have not been published yet but we have shared our submission with the Authority.²⁸

MBIE "note[d] that the range of benchmark ITPs [used by the Authority] appears large relative to the retail gross margins needed for a retailer to be competitive. This makes any definitive conclusion about retail competition difficult".

We agree with MBIE the benchmarks do not provide a useful comparator. The benchmarks need to be realistically achievable by independent retailers to determine the extent of the price squeeze/price discrimination/competition problem. For the purpose of comparing margins and profits it may be useful for the Authority to use a uniform ITP benchmark that is realistically achievable by independent retailers.

The disclosures can only be "expected to help build confidence in the market" if the problems they highlight are addressed and not masked by artificially low and unrealistic benchmarks.

By way of illustration, the reason Mercury and Meridian's ITPs are within the Authority's benchmark range is principally because the range includes an implausible "Minimum of monthly hedge prices (overall minimum)" benchmark, and a backward looking "Average hedge prices for 12 quarters to the quarter prior to the target financial year". It is disconcerting Mercury's FY22 ITP includes a reduction of \$13/MWh attributed to "management discretion".²⁹

Concluding remarks

We support the Authority's initiatives to improve information disclosure and market monitoring.

The disclosure requirements/proposals can be enhanced by resolving limitations with the existing ITP and gross margin disclosure requirements.

We doubt the Authority is happy with market participant perceptions of the extent to which it holds participants to account and nor should it be. It is important market monitoring is undertaken without fear or favour, and the Authority is seen to be holding all market participants to account for their conduct.




Regardless of how good the information disclosure rules, and Authority's market monitoring, are they can only go so far in resolving market failures. Disclosure and monitoring can reduce information asymmetries not market power.

Regulation is needed to address issues of market power and, potential and/or actual, abuses of market power. One 'truism' over the last 30 years of electricity and network industry reform is the consistent failure of 'light-handed' regulation.

²⁸ 2degrees, Electric Kiwi, Flick Electric and Pulse Energy, Stronger competition is key to affordable electricity and a successful energy transition, 2 November 2023.

²⁹ "Management discretion: ITP kept the same as FY21 with an adjustment for management discretion to reflect volatility during the budget process caused by disruptions from Covid-19 lockdowns in New Zealand." Source: <https://www.emi.ea.govt.nz/Retail/Datasets/InternalTransferPricing/2022>

Yours sincerely,

<p>Emma-Kate Greer Chief Corporate Affairs Officer Emma-Kate.Greer@2degrees.nz</p> 	<p>Luke Blincoe Chief Executive luke.blincoe@thecollective.energy</p> 
<p>Pavan Vyas Chief Executive pavan.vyas@flickelectric.co.nz</p> 	<p>Sharnie Warren Chief Executive sharnie.warren@pulseenergy.co.nz</p> 