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Competition Taskforce

Electricity Authority
PO Box 10041,
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via email: TaskForce@ea.govt.nz

4 November 2024

To Members of the Competition Taskforce,

Energy Competition Taskforce - request for level playing field measures

Octopus Energy welcomes the Taskforce's focus on measures that help New Zealand achieve a level playing field in the Electricity Market.

It's crucial for the Taskforce to consider the various opportunities for dominance within generation and retail markets. Equally important is to consider measures that would prevent such occurrences. The Taskforce must also ensure that these measures are designed and implemented effectively.[1]

Level playing field measure design

The potential for new entry is an important feature of an effectively competitive market, particularly where ownership among existing participants is concentrated. New entry constrains a participant's ability to exercise sustained market power. High levels of concentration can create barriers to entry, particularly where firms are integrated across vertical markets.

Establishing a level playing field is essential to enable and encourage market entry by new participants. It also minimises the risk of companies engaging in anti-competitive behaviours that may otherwise result in customers paying higher prices or receiving lower-quality/less innovative services.

An unlevel playing field can manifest in several ways, including:

- **Abuse of market power through non-price means**:
    - Refusal to deal, e.g., offering risk management contracts internally that are unavailable to third parties.

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[1] We note that the Internal Transfer Pricing Rules recommended by the Electricity Price Review were not effectively implemented.

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- Non-price predation, e.g., varying the quality of service depending on the user, such as applying force majeure or imposing onerous credit terms.
- **Abuse of market power through price**:
  - Margin squeeze, e.g., offering prices to an external party that are higher than the internal price used for retail offer pricing.
  - Predation, e.g., providing below-cost pricing to a consumer that undercuts a PPA or physical energy solution provided by an independent generator.
- **Misuse of information**:
  - Integrated firms may legitimately collect information as part of providing services, but there is significant potential for this information to be used to disadvantage competitors.

We highlight these because the concept of a level playing field is core to market design. There is potential to address most of these risks using different tools and regulatory design elements. They will be delivered through a variety of methods: legislation, regulations, licence conditions and market rules (Inconveniently for responding to your request they're unlikely to be labelled 'level playing field measures').

The gold standard approach for designing a level playing field is to legally separate vertically integrated firms, as was the case with Telecom. However, rules can also be designed to mitigate many of these risks. There are numerous avenues for doing this. As an illustration the problem of a margin squeeze could be resolved through:

1. Designing a market process that eliminates the risk e.g requiring all gentailers to offer all 'risk management' products to be offered to the market, and requiring all retailers to purchase a level of cover from the market; or
2. Prohibiting cross subsidies and discriminatory pricing as part of segment accounting rules on vertically integrated firms.

International precedent

As highlighted above elements of a level playing field will be embedded through different elements of market design. There will be many examples for the Taskforce to draw on from electricity and other vertical industries in New Zealand and abroad[2].

We've previously shared UK licence conditions and 'Secure and Promote' reform measures as an example of level playing field measures. I have included these again for your reference.

UK licence conditions

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[2] Australian conduct rules
https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6420
Australian Competition Concerns, ACCC made recommendations about liquidity measures and supporting new generation
https://www.accc.gov.au/system/files/accc-inquiry-national-electricity-market-december-2023-report_0.pdf).
New Zealand's Commerce Commission administers access regimes across Diary, Grocery and Telco sectors.

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Measure	UK Reference
Separate legal entities are required for activities in the electricity value chain: generation, transmission, distribution, retail/ supply. *A common owner of these licenced entities is allowed.*	Refer OFGEM licensing arrangements. https://www.ofgem.gov.uk/industry-licensing/licences-and-licence-conditions The licences generally require fit and proper governance and management of the entities.
Prohibition on cross subsidies.	Generation Licence *Condition 17A – Prohibition on cross subsidies: generators are prohibited from giving or receiving a cross subsidy from another related business in certain circumstances.*
Prohibition on discriminatory terms.	Generation Licence *Condition 17 – Prohibition of Discrimination: generators are prohibited from selling or offering electricity to any person or business on terms that* are materially better or worse than those on which it sells or offers to comparable wholesale purchasers.
Accounting separation rules.	Generation Licence *Condition 15 – Regulatory Accounts: generators are required to keep separate accounts for each business, including accounting records of transfers or allocations between businesses.*

Secure and Promote
OFGEM's 'Secure and Promote' changes in 2014 also supplemented these conditions with rules around contracting conduct (including standardised credit requirements and timeliness of requirements) and market making arrangements.

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They have played a role in the market's evolution, some of these have now been revised (e.g market making, although this is now under review and likely to be reinstated) because there has been significant change in the market with reduced concentration of firms and less vertical integration.

Measures to Support Generation Entry

The measures outlined above will support a more robust contracts market, which is likely to enhance the sustainability of independent generators and retailers. Additionally, we believe it is worth considering whether further arrangements are necessary to support the market for new generation.

New Zealand will require investment from parties beyond the incumbents to build generation at the speed necessary to decarbonise the economy affordably. Significant barriers exist for non-vertically integrated or new-generation participants to obtain financing and manage market exposure. These participants need long-term contracts from a high-credit-rated retailer (often gentailers with no incentive to contract) or large industrials (of which there are few).

This issue is not unique to New Zealand. For example, the Australian Competition and Consumer Commission (ACCC) identified similar issues in Australia and recommended policies to support new generation through government- or consumer-levy-backed long-term generation contracts.

Other markets have addressed this barrier with Contract for Difference (CFD) arrangements, where costs can be levied on consumers (or the government can meet its demand with new generation contracts). This approach recognises the consumer benefits of ensuring supply sufficient to meet growing demand and achieve price stability, while also addressing the high costs and inequity associated with supply shortages.

Please contact me if you have any further questions or comments about this letter,

Margaret Cooney
Chief Operating Officer
[redacted]