Great value energy
for families and businesses

nova energy

Nova Energy Limited
PO Box 10141, Wellington 6143
www.novaenergy.co.nz

23 October 2018

Energy Market Policy Team

Ministry of Business, Innovation and Employment

By email: Energymarkets@mbie.govt.nz

Re: Submission on electricity pricing review discussion paper

Nova Energy (Nova) appreciates the opportunity to contribute to the electricity price review discussion paper.

Nova Energy has been a generator and retailer in the New Zealand electricity market since its establishment (under another name) in the late 1990's when competition for electricity supply was introduced. Since its establishment Nova has grown and now supplies ~79,000 electricity customers and is the 6th largest retailer in New Zealand. Nova also owns or has an interest in over 200MW of generation capacity and has recently commenced construction of a 100MW fast start gas peaking power plant in the Taranaki region that should be commissioned during the first half of 2020. Nova Energy also retails gas to ~30,000 gas customers and is a major supplier to the wholesale, industrial and commercial gas market.

Since the release of the discussion paper Nova has been engaging through industry bodies that it is a member of including the Electricity Retailers Association of New Zealand (ERANZ) and Business New Zealand and has supported those organisations in the commissioning of several independent expert reports examining the electricity market. Nova believes those reports and the submissions of ERANZ and Business New Zealand will provide valuable insight to the electricity price review panel.

Key points for consideration

Nova recognises that affordability is a key issue for an increasing number of New Zealanders and the report's assessment that the number of households in a position of "energy hardship" could be as high as 100,000 is a concern for us all.

The New Zealand electricity market is an important mechanism that enables private investment to be made in a sector that can only be described as capital intensive. Spot and wholesale markets support a price discovery process that facilitates not only efficient plant dispatch but also provides investors and consumers with pricing signals that direct investment in new capacity, energy efficiency and consumption behaviour.

The Government has introduced multiple measures with the objective of reducing carbon emissions. This includes the Zero Carbon Bill, proposal relating to the Emissions Trading Scheme and amendments to the Crown Minerals (Petroleum) Act. Analysis provided by the Productivity Commission shows that transitioning to electric vehicles for transport and electricity for process heat represent significant opportunities for how New Zealand may meet long term emissions objectives and accordingly demand for secure, reliable and affordable electricity is expected to increase. This growth in electricity demand will also need new investment in generation. As such New Zealand will need to maintain a functioning and orderly electricity market if it hopes to attract the private investment that it will need to meet its objectives.

Nova's submission contains a number of suggestions for incremental improvement of market arrangements that it believes could assist in addressing affordability issues for consumers. It is important that the challenge of meeting those needs is achieved without changing the fundamental structure of the wholesale market. Nova believes this is important if the Government wishes to achieve its wider policy objectives.

Nova is available to discuss these and any other matters as appropriate.

Yours sincerely

Commercial & Regulatory Manager

ELECTRICITY PRICE REVIEW

SUBMISSION FORM

How to have your say

We are seeking submissions from the public and industry on our first report into the state of the electricity sector. The report contains a series of questions, which are listed in this form in the order in which they appear. You are free to answer some or all of them.

Where possible, please include evidence (such as facts, figures or relevant examples) to support your views. Please be sure to focus on the question asked and keep each answer short. There are also boxes for you to summarise your key points on Parts three, four and five of the report – we will use these when publishing a summary of responses. There are also boxes to briefly set out potential solutions to issues and concerns raised in the report, and one box at the end for you to include additional information not covered by the other questions.

We would prefer if you completed this form electronically. (The answer boxes will expand as you write.) You can print the form and write your responses. (In that case, expand the boxes before printing. If you still run out of room, continue your responses on an attached piece of paper, but be sure to label it so we know which question it relates to.)

We may contact you if we need to clarify any aspect of your submission.

Email your submission to energymarkets@mbie.govt.nz or post it to:

Electricity Price Review

Secretariat, Ministry of Business, Innovation and Employment

15 Stout Street

PO Box 1473

Wellington 6140

Contact details

Name	[redacted] **Commercial & Regulatory Manager**
Organisation	**Nova Energy Limited**
Email address or physical address	[redacted]

Use of information

We will use your feedback to help us prepare a report to the Government. This second report will recommend improvements to the structure and conduct of the sector, including to the regulatory framework.

We will publish all submissions in PDF form on the website of the Ministry of Business, Innovation and Employment (MBIE), except any material you identify as confidential or that we consider may be defamatory. By making a submission, we consider you have agreed to publication of your submission unless you clearly specify otherwise.

Release of information

Please indicate on the front of your submission whether it contains confidential information and mark the text accordingly. If your submission includes confidential information, please send us a separate public version of the submission.

Please be aware that all information in submissions is subject to the Official Information Act 1982. If we receive an official information request to release confidential parts of a submission, we will contact the submitter when responding to the request.

Private information

The Privacy Act 1993 establishes certain principles regarding the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information in your submission will be used solely to help develop policy advice for this review. Please clearly indicate in your submission whether you want your name to be excluded from any summary of submissions we may publish.

Permission to reproduce

Summary of questions

Part three: Consumers and prices

Consumer interests

1. *What are your views on the assessment of consumers' priorities?*

There are multiple types of customers. A large proportion are agnostic to their supplier, presumably because their electricity bill is ~3-5% of their household income. They don't switch suppliers unless there is a trigger.

There is another group that is looking for the best price and they do switch, and achieve savings offered by acquisition tariffs.

The third group are the households who struggle to meet their bills on essentials, like housing, food and electricity. Nova shares the view that they need help.

The case studies in the Issues Paper illustrate many of the elements that underlie the general concern around energy affordability. A poverty trap occurs where continued short term pressure on the household budget mean that household costs are commonly higher than they would be if the consumer had greater flexibility and ability to manage their purchasing decisions for all of their basic needs. Electricity is part of that mix.

Potentially the Consumer NZ's 2018 Energy Provider Survey is at the other end of the scale. If the Consumer survey population is drawn from their membership base (and we cannot tell if that is the case or not) then the survey could be skewed towards financially secure households. That group tends to be proactive in their choice of supplier and the survey highlights options and information that they believe should be available. Their member preferences and views in general may not reflect the majority of consumers.

There is a theme in the Issues Paper that suggests consumers that switch go through process of deciding to select a new electricity retailer, then evaluate alternatives and make a decision to switch. While that will obviously be true in some cases, the overriding majority of switch decisions are made after some event has triggered the consumer to make a switch. This may be a price increase, a high monthly bill, an event that causes dissatisfaction with their electricity supply, an approach by another retailer with an attractive offer, the process of moving house, or some other reason.

This point is important because it has implications on how the issue of disengaged consumers is addressed. For instance, the government's recent announcement that door-to-door sellers that ignore "Do Not Knock" stickers will face prosecution under the Fair Trading Act. This, plus the application of restricted lists on direct marketing campaigns, will restrict to ability of challenger retail electricity brands to encourage disengaged consumers to switch to a better electricity deal. Retailers know from experience that consumers do not generally change electricity retailers in the absence of a 'nudge' from a sales person, either directly or over the telephone.

2. *What are your views on whether consumers have an effective voice in the electricity sector?*

Given the complexities involved with the electricity sector, it is difficult for consumer groups to effectively engage with regulators and the industry in general to understand and thereby provide informed comment on different aspects of the electricity market.

Creating a consumer panel or similar might help overcome some of those difficulties if it is provided with appropriate support. It could perhaps be set up as another advisory group under the auspices of the Electricity Authority, or alternatively the Commerce Commission.

That would provide consumer representatives with the opportunity to question and challenge existing and proposed market arrangements with the regulator.

We believe that better informed consumers or their recognized representatives will improve confidence that the New Zealand supply system does generally deliver safe, secure, reliable and affordable energy.

3. *What are your views on whether consumers trust the electricity sector to look after their interests?*

Nova's own surveys indicate that a clear majority of Nova's customers see Nova as a trustworthy retailer.

Anecdotal evidence however suggests that there is a large number of consumers that do not trust the electricity sector to look after their interests. This view is likely exacerbated by:

- the process of introducing new technologies, such as AMI meters,
- applications for cellphones, and
- data management and associated concerns over data usage and privacy.

Regular reviews of the industry and negative publicity associated with annual price changes and a lack of understanding of how the industry operates likely also contribute to negative perceptions of the industry.

It is not in anyone's interests for consumers to mistrust retailers' or have an unrealistic expectation of what levels of reliability electricity retailers and distributors are able to provide.

This is an area where more support for consumer advocates could be of benefit to the industry overall.

Prices

4. *What are your views on the assessment of the make-up of recent price changes?*

Reviewing the delivered energy price is useful background information but is not particularly informative as to the identification of issues in its own right. To make an informed view it is necessary to understand the constituent parts of the delivered energy price and the costs and risks of each of those parts.

The overall summary of price movements is fair, but the conclusion that 'retailing charges were the biggest component of residential price rises between 2004 and 2018' ignores some of the reasons for that change:

Generation costs (due to gas prices, and evident in industrial price movements) and distribution prices moved up significantly between 2000 and 2004. Over that period residential prices had not kept up, i.e. there was a squeeze on retail margins. Retail margins gradually recovered after 2004.

Another point is that Commercial and Industrial consumers offer scale and carry lower credit risk, and are more inclined to secure electricity supply contracts for fixed periods of time and known volumes. This reduces the retailer's risk in each sales transaction, which results in much lower sales margins overall to this group.

5. *What are your views on the assessment of how electricity prices compare internationally?*

New Zealand's industrial and residential electricity prices compare favourably against their respective international comparison tables. The industrial sector prices are likely more internationally competitive than residential rates due to:

- High voltage transmission costs are more comparable between countries for large scale customers,
- Industrial demand is more base-load in nature, and
- The dairy and agriculture industry's load peaks in summer rather than winter, thereby being cheaper to supply than residential consumers with a winter peak demand.

Residential consumers on the other hand tend to be considerably more geographically dispersed in New Zealand than other countries. This impacts on comparative costs of distribution, sales and metering (including the cost of installing new advanced meters and the associated communications costs).

That said, New Zealand's residential pricing still favours comparatively well against other OECD countries, especially given that New Zealand has an enviable renewable generation proportion of ~ 80% (with no current subsidies) and faces the issue of a lack of economies of scale due to a small population relative to geography and land mass.

We note also that quantity of electricity consumed together with price is important. It is often noted that New Zealand housing stock has a poor record in relation to insulation and moisture and as more energy is required to heat a home to an acceptable standard so irrespective of favourable price comparisons, households pay more due to having to use higher quantities of electricity.

6. *What are your views on the outlook for electricity prices?*

It is likely that peak prices will increase more so than average prices due to changes to the structure of distribution prices, and the increasing cost of CO_2 emissions for thermal generators.

Increased peak prices will incentivise consumers to moderate their demands on generation and distribution during these periods. It also incentivises the development of generation to meet demand peaks or meet supply shortfalls when there is insufficient supply from intermittent renewable generation.

It is important that Government and consumer representatives help the industry communicate the reasons behind such changes, and not leave consumers feeling that they are being "fleeced".

The extent to which prices might change overall is less certain, and will depend somewhat on the timing and cost of new generation development. If excessive pressure is exerted to achieve the 100% renewable generation target (at average inflows) then the long-run cost of generation may increase substantially given the need for reserve generation capacity to cover dry hydro shortfalls that will have very little utilisation.

Affordability

7. *What are your views on the assessment of the size of the affordability problem?*

Nova supports the analysis in the PwC report 'Definition of Energy Vulnerability in New Zealand' released by ERANZ. PwC's report considers a range of factors that contribute to how vulnerable households are to energy costs. Based on that analysis, it is estimated that ~44,500 households are identified as being in the most need of assistance. Energy hardship is linked to households that also cannot afford to pay for other essentials like housing and food. The number of consumers in energy hardship is, in Nova's view, similar to those that struggle to make ends meet on all three fronts housing, food and energy. The analysis performed is statistical in its nature and can't identify precisely who those consumers are and where they live without the assistance of Government agencies together with the retailers who service them.

The charts in Figure 11, page 27 of the Issues Paper also illustrate that there are more factors than income causing 'energy hardship'. Even households with incomes of over $100,000 or more occasionally lose the PPD, or have their power cut off, because they elect to be make other spending choices or suffer short term cash shortfalls.

There are also clearly different levels of need, and these change over time for households as their individual circumstances change. In many cases, people may not be able to pay an electricity bill on time because they are either: between jobs, have incurred a major one-off expense or some other short term reason. It is common for households to have minimal savings and limited ability to cover one-off expenses or even regular expenses from time to time, even if their income is adequate in every other sense.

This underlines the basic problem of trying to address 'energy poverty'. There are certainly households that warrant support, but care needs to be taken that this does not create the wrong type of incentives for parties that do have the resources to manage their own energy needs and are free to make their own decisions as to expenditure.

Any policy aimed at addressing energy hardship needs to be carefully targeted and

have sufficient flexibility that it does not become a benefit to those that no longer have a need for support.

8. *What are your views of the assessment of the causes of the affordability problem?*

To the extent that affordability is an issue, then there are many factors at play that need to be addressed. Energy affordability is a problem that is symptomatic of a number of factors including:

- income levels,
- education,
- housing (location and quality),
- and family choices.

Many of these issues are intertwined and can only be resolved together through long term policy settings.

New Zealanders largely live in stand-alone houses that are more expensive to develop, maintain, and heat than the apartments and terraced housing typical of more highly populated parts of the world. The focus on stand-alone housing, which in some cases may be over leveraged and over-priced, makes it particularly difficult for households that are struggling to meet their accommodation costs.

It is clear however that the market price structures and prompt payment incentives that currently apply to encourage households to manage their energy usage, select a low cost provider, and pay their accounts on time, can also be a barrier to a warm and healthy home for some groups.

As discussed above, affordability can also be a short term problem for households that have temporary accommodation changes, loss of income, or one-off type expenses.

For this reason, the Winter Energy Payment fails to provide any meaningful relief to disadvantaged consumers at the critical junctures when they need support.

9. *What are your views of the assessment of the outlook for the affordability problem?*

Given the current low level of unemployment and strength of the economy and the low emissions objectives the Government has for the country it seems unlikely that we can rely on further improvement in macro-economic factors to improve energy affordability at least in the short to medium term. Further, the Crown Minerals (Petroleum) Amendment Bill, if enacted, will likely create an energy gap and higher prices[1] .

Initiatives to improve housing quality through insulation programmes etc. must be a key part of the mix, but retrofitting some properties will not be viable and upgrading is a process that takes place over an extended period of time.

Where landlords upgrade the quality of rental properties then there will also be an expectation for higher rental price to cover the additional capital investment. As such, improvements in housing quality may not immediately address the affordability issue. Nevertheless, such improvements may still assist in addressing some of the second order effects of poor housing quality; such as in reducing health related issues and better education outcomes for children.

Encouraging the building of a sufficient volume of new accommodation to effectively displace the poorest housing stock must be part of the Government's equation.

[1] See Submission to the Environment Select Committee by Todd Corporation, dated 11 October 2018

Summary of feedback on Part three

10. *Please summarise your key points on Part three.*

Consumers can struggle with energy affordability for a wide variety of reasons, the more significant of which will be their income at any point in time and housing situation. After that it depends on energy usage, which mostly impacts those households with one or more members at home throughout the day.

The electricity price is of secondary importance. While nominally, most consumers can select a low cost electricity provider, and minimize costs through prompt payments, there are circumstances where some consumers are not able to minimize the price they pay.

The electricity sector cannot address that situation alone. The effective operation of the competitive electricity market is key to efficient resource allocation and minimizing costs to New Zealand as a whole, but it is not necessarily able to account for specific consumers circumstances and in particular those on low incomes or those that have limited financial resources at their disposal.

An example is the use of prompt payment discounts (PPD) to incentivise consumers to pay their bills on time. The challenge the industry faces is that if they cannot apply incentives for prompt payment of electricity invoices, then there is a risk that group of consumers may habitually pay their bills late and create increased costs across the whole sector. Simply replacing a "prompt payment" discount with a late payment penalty does not improve the outcome for the consumer who has difficulty paying their bill and potentially makes it worse.

Solutions to issues and concerns raised in Part three

11. *Please* briefly describe any potential solutions to the issues and concerns raised in Part three.

In a low carbon world the majority of people will need to be housed in energy efficient multiple unit buildings within easy reach of facilities and services, either on foot or public transport. In that environment energy consumption is reduced and vehicles, electric or otherwise are less critical to a modern lifestyle.

Nova notes that Retirement Villages, for instance, will help retired persons move from older poorly insulated houses to modern accommodation; while at the same time enabling those seeking family homes to move in and upgrade those same properties.

Obviously that will not solve the short term issues for most disadvantaged consumers, but the point illustrates the need for a broader perspective on the issues than just energy prices.

Nova is supportive of ERANZ Access to Energy (A2E) projects which focus on practical solutions for people to have warm dry homes but believe that Government agencies are in the best position to identify and provide support to households who are in genuine need of energy assistance with the assistance of retailers to deliver that support in a targeted and least cost manner. ERANZ is committed to developing these initiatives and has employed specialist resource to develop initiatives in partnership with relevant Government and non-Government agencies.

Should the Government consider providing direct support to consumers experiencing energy hardship, Nova suggests that consideration be given to modification or enhancement to the Winter Energy Payment scheme by adding or replacing the Winter Energy Payment an 'energy assistance tariff' (or EAT) that can be made available to

selected households based on need.

The concept behind the EAT is as follows:

- The EAT is a reduced price tariff, with no fixed charge and an energy price in line with retailers standard tariffs.
- One or more retailers are selected through a tender process to service consumers with an EAT.
- households meeting specific hardship criteria as determined by MSD qualify for EAT.
- Customers eligible for EAT will be required to switch to one of the retailers identified by MSD. The retailer will manage the EAT consumers in line with their other customers, except that they can invoice MSD for each EAT customer on the basis of the agreed tender price.
- When a consumers circumstances change, either MSD will terminate an ICP receiving an EAT, or a switch occurs at the ICP which will automatically revoke the EAT.

Additional features could include:

- The EAT retailer providing notice to MSD or a Community agency as appropriate if the consumer misses a payment on the account, thereby ensuring effective continuing engagement.
- The EAT could be set at two or more different levels, depending on the degree of assistance required.

The benefit of this proposal:

- is that the assistance is clearly targeted,
- the cost to the Crown is minimised through the tender process,
- normal retail account management processes and payment disciplines are applied,
- the benefit is direct and cannot be used by the beneficiary for alternative purposes, and
- accurate ongoing reports can be made available on the beneficiaries of the program and their energy usage, ensuring the program can be well managed.

This suggestion is intended as something that could be considered under the ERANZ Energy Assistance project and in extension of the project in relation to bulk purchasing of power for Housing New Zealand tenants.

A further possibility is one that would involve cross subsidies operating between electricity consumers.

It involves holding all electricity retailers responsible for meeting a share of the costs incurred in servicing disadvantaged consumers. Similar to the EAT proposal, MSD would be responsible for making Supported Electricity Consumption Certificates (SECCs) available to vulnerable and disadvantaged consumers.

- Like the EAT, SECCs would be an approved tariff with a reduced fixed charge.
- Instead of government funding however, retailers would be required to hold a proportionate share of SECCs in ratio with their overall market share of consumers with Category 1 meters.
- Those retailers' unwilling or unable service SECCs accounts would need to pay another retailer to make up their respective share of SECCs.
- Very small retailers could be excluded, say less than 10,000 ICP's, but above that size every retailer would have to participate.
- The Electricity Authority could monitor SECCs balances and facilitate a trade in SECCs payments between retailers.
- The value of SECCs trades would reflect the comparative margin between SECCs approved customers and the cost of servicing those accounts.

- Retailers with products that do not match the SECCs tariffs would not need to change their customer models and service SECCs customers, but would instead be able to purchase and hold SECCs from retailers that do.

Retailers would need to recover the cost of servicing SECCs customers from their wider portfolio of Category 1 consumers. That is not a lot different from the current model, where the largest retailers are in effect acting as retailers of last resort, except that it is providing a direct cost reduction to disadvantaged consumers and would be explicit in its operation.

Part four: Industry

Generation

12. *What are your views on the assessment of generation sector performance?*

The establishment of the wholesale market in the 1990's brought about a number of outcomes:

- Enabling private investment in the sector and in particular generation capacity, which is by its very nature capital intensive. This has relieved the burden and risk from government.
- The process of discovery of short run (spot) wholesale prices enables efficient allocation of resources balancing supply and demand and the costs of thermal and renewable generation which have significantly different costs structures.
- The wholesale market also facilitates long run price discovery. That is important for parties making investment in new generation capacity and for consumers in determining how they manage their energy consumption through investing in energy efficiency and making fuel choices.

The market has developed overtime and has increasingly enabled a resilient and highly renewable power system. The market has had to cater for a number of challenges including:

- Supply and demand events, such as the failure of major transformers at Huntly and Tiwai
- Several droughts resulting in significant shortfalls of hydro generation,
- Replacement of ageing and inefficient thermal facilities,
- The expansion of intermittent wind generation,
- Difficulties in consenting renewable projects – large hydro projects in particular,
- Introduction of the Emissions Trading Scheme.

Of critical importance is that the market continues to provide the appropriate price signals to support investment decisions. Those signals include the daily and seasonal price dynamics so that the right types of generation attract capital investment in order to best meet demand. This is also important in the context of the Government's policy objectives with respect to the transition to a low carbon emissions economy. The electricity sector is expected to play a central role in meeting those objectives.

The operation of the market and the role of the wholesale market price is a central mechanism for firms and consumers to make decisions as to capital allocation and

consumption behaviour. Interference in the orderly conduct of the market and discovery of efficient price signals risks unintended consequences that undermine security of supply and environmental outcomes.

We note that if there was evidence of excessive profits being made in the industry then that would have resulted in an excess of new generation capacity being built and surplus capacity. If anything, the evidence is that wholesale prices have been low in recent years and that has resulted in the entry of new retail entrants (over 40 at the last count); resulting in reducing retail margins as reported by major publically listed participants and lower prices for consumers despite limited investment in new generation capacity. These outcomes are the natural responses to wholesale price signals that markets create and that are more effective than centrally planned processes that have historically led to poor outcomes at the expense of consumers and taxpayers.

13. *What are your views of the assessment of barriers to competition in the generation sector?*

Prospective generators need access to significant financial capital, ability to obtain resource consents through the Resource Management Act process and the ability to access technical capabilities and resources to build new generation. These hurdles can be significant and the risks of failure are high but in general the market is open for any party to participate on an even playing field.

We note the comments with respect to the depth of the contracts market and we have responded on that issue with respect to small generators under the question 17 related regarding vertical integration.

A significant barrier to building new generation is obtaining the necessary resource consents, particularly for renewable generation. It is not just the time and costs involved with this process, but the uncertainty that creates in not knowing the final outcome and whether the project being envisaged will still be economic under the conditions imposed as part of the consent.

As has been noted in the Issues Paper, consents issued under an initial understanding of the opportunity can also become limiting in the context of applying new, more economically viable technologies at a later date.

In comparison, the other components of securing a sound proposal for new generation; such as securing funding, fuel, and engineering estimates, are all quantifiable with reasonably well understood levels of risk. The process of requiring resource consents can therefore itself lead to the choices of generation projects undertaken being somewhat different than what would apply in the absence of that risk.

When there is the risk of political intervention in the electricity market as well, then this also increases project risk.

14. *What are your views on whether current arrangements will ensure sufficient new generation to meet demand?*

Recent changes to the Crown Minerals Act prohibiting any further release of acreage for off-shore exploration for oil and gas will have a chilling effect on participant's ability and willingness to confidently invest in new thermal generation to back-up renewable generation during dry hydro conditions and when wind generation drops off. This is likely to increase the overall delivered cost to the consumer due to the sub optimal overbuild of renewable generation required to meet demand, whilst delivering lower than expected return for the investor. That is because the wholesale prices will be lower due to over-capacity during normal hydro and wind periods.

The net effect is an increased risk of the industry not building sufficient generation capacity to meet demand.

Potentially; consideration may need to be given to introducing capacity payments for dispatchable generation when the proportion of renewable generation grows to the point that security of supply is at risk. A capacity payments regime may be needed in order to meet the Government's 100% renewable by 2035 target. Regulators currently need only continue to monitor the markets ability to continue to provide sufficient security of supply to manage security of supply to standards accepted by consumers in general.

Retailing

15. *What are your views on the assessment of retail sector performance?*

The Issues Paper provides a fair overview of the retail sector performance, but that largely glosses over many of the challenges that retailers have been working through to deliver the prices and services that they wish to provide to consumers.

Nova Energy's expansion in to new networks, for instance, has been repeatedly delayed by slow engagement by networks on negotiating Use of Systems Agreements and on reaching agreement on some terms of those agreements.

We believe strongly that the best solution to this issue is a standard default UoSA that is available to any retailer seeking to trade on a network. That default UoSA agreement should be able to be used in the event that the parties cannot agree terms within a suitable period of time (3 months) and can be superseded by new terms should they the subsequently agree better terms. The EA has a work program in place for this but progress has been very slow in execution.

PPD

The level of prompt payment discounts (PPD) applied by different retailers has arisen through a range of circumstances, and some retailers apply different rates for different retail offerings.

In Nova's case the level of PPD that is not taken up by customers (or credited back to customers) is approximately equal to Nova's overall credit management costs, i.e. the 'penalty' element is roughly cost reflective. These costs include a considerable level of direct engagement with consumers that are having difficulty in paying their accounts, and in many cases the PPD lost is refunded as an incentive for consumers to get their payments in order.

Nova suggests that an option that could be explored is to cap the level of PPD to be applied by retailers to a certain level, say between 10 and 15 percent. This would deal with the issue of over recovery of the credit costs as well as having the added benefit of making it easier for consumers to compare tariffs. In principle we believe that the level of prompt payment discount should be broadly cost reflective.

Eliminating the PPD entirely would merely serve to increase overall credit management costs and result in those costs being spread across all consumers and can create perverse incentive for consumers in general. This would be particularly difficult for new entrants where cash-flow is vital, especially in early years of operation; We also believe that if prompt payment discounts (and by inference late payment penalties) are prohibited through regulation then this may cause retailers to place a greater emphasis on credit checks for all new accounts and seek out new strategies to achieve the same outcome to manage late payments. That would not be an improvement for consumers overall and could create an additional barrier for consumers with a poor credit history.

Prior to the introduction of PPD in the early 2000s, the common practice was for the retailers to charge a bond in the form of 1 month's energy cost from those customers with low credit rating. Introducing such a practice to mitigate risk of credit default will more severely impact those who can ill afford it. PPD in our view was an improvement to the previous arrangement, especially in a market that has enabled customer switching to occur within a matter of days.

Distribution costs

The Issues Paper notes how some retailers failed to pass on a reduction in distribution charges. Nova absorbed earlier price increases over the previous three years for that network to keep its prices the same. That was to consumers' benefit.

Vacant properties

A cost that is rarely acknowledged for retailers is the ongoing fixed lines charges they incur on vacant properties. The retailer is responsible for the ongoing cost for the lines connection and meter lease at a vacant property. This continues until such time there is a new occupant leases or rents the vacant property, the landlord assumes responsibility for the costs, or the retailer pays for the cost of physically disconnecting the property.

Landlords ought to be responsible for the continuing connection and metering charges, but retailers are rarely able to engage with the property owner in addition to the residents. The costs of physical disconnection typically exceed the expected vacancy cost, but this depends on the timing of the new lease, something that the retailer has no control over.

Consumers are also frequently caught out by this as they are generally assumed to be responsible for all electricity consumption since the last tenant moved out. In many cases it is difficult for them to prove otherwise, particularly if they did not contact a retailer at the commencement of their lease. Disadvantaged consumers are the most likely group to be caught by this unreasonable cost.

This issue could be resolved if the incumbent retailer, in the event of their customer leaving a leased property, had the legal right to switch the existing supply contract to the property owner. The property owner is in the best position to make a choice on whether to maintain the connection in the interim, and ensure that any new tenant switched the account over when moving in. This would prevent consumers being caught with costs that they should not incur, and reduce the overall costs of supply to all consumers.

16. *What are your views on the assessment of barriers to competition in retailing?*

The cost of dealing with a large number of distributors and the number and variety of distribution tariffs is a significant impediment to rolling out a new retail offering. Many of the smaller retailers have simplified this process by simply signing up to whatever Use of Systems Agreement is presented to them as to do anything else is simply too great a challenge in terms of legal costs. While this is expedient, they can also face risks in meeting the terms of those agreements.

The need to provide a low user tariff in addition to standard tariffs also doubles the complexity for administration and sales people to manage, as well as the added complexity for consumers.

The growth in the number of embedded networks is also adding to the cost of servicing commercial customers and has the effect of severely limiting the choice of retailer for those consumers.

Vertical integration

17. *What are your views on the assessment of vertical integration and the contract market?*

Nova believes the current arrangements for the electricity hedge market are largely effective. It notes the spreads charted in Figure 19 of the Issues Paper and agrees that it would be preferable if liquidity and spreads could be maintained through periods of low hydro storage or limited generation availability.

Nova also notes however that it is unreasonable to expect to be able to buy house insurance in the days before a major cyclone, or in the middle of a swarm of earthquakes. Even in the absence of vertical integration, it can be expected that the majority of parties would be hedged well before any major moves in wholesale electricity prices. Price discovery during periods of considerable uncertainty can result in wider than usual spreads and limited liquidity.

This is particularly true in the New Zealand context as low hydro conditions have the effect of physically limiting the available supply.

We suspect that if parties are caught out by short term significant shifts in market prices that may be a symptom of a lack of knowledge and experience in relation to risk management – a core competency for retailers.

Nova is currently a medium sized generator retailer. It has grown from being a small generator and has invested over $100 million in generation to enable higher cover for its retail sales.

Nova strongly opposes any move requiring generators to sell hedges as it would unreasonably penalize Nova which has proactively invested capital to manage its own retail exposure, only to be forced to sell to new upstart retailers. Any forced market making requirement must only apply to those generators that have more than 15% of market capacity or alternatively; to be equitable, all retailers and generators regardless of size should have to be market makers. The latter option would become a barrier to entry for retailing.

We note the EA's early 2017 investigation into complaints from some small retailers that larger gentailers were selling to consumers at prices lower than prices available on the ASX future market. The Issues Paper refers to that investigation and note that 12% of contracts being below the ASX futures price should warrant further investigation. We note that possible reasons for below ASX futures prices could include mistake and error in contracting or reporting via the disclosure website or that there is another

element to the supply arrangement that justifies a reduced price. In our experience electricity pricing for larger loads is complex including sophisticated distribution pricing and requires careful analysis of locational pricing and consumption profiles that may differ among competitors. In our view 12% is not so high given that 88% are above the ASX futures price. The conclusion that margins are positive but on average quite low for this consumer group demonstrates the level of competition that exists at this level of the market.

Further investigation may be beneficial and serve to provide more confidence in the market for consumers and participants in general or unearth as yet unidentified issues.

Another mitigating factor in the issue of efficiency in the wholesale contracts market is role of intermediaries that provide services to both small generators and larger consumers. Simply Energy provides a wholesale clearing service and matches generators and consumers or small retailers. Energy Link and independent brokers act on behalf of small generators and larger consumers to secure the best contract terms available and also tend to provide advice as to risk management and other technical matters relating to the market. The existence of these intermediaries for some time shows that the market has developed a level of maturity that supports efficient wholesale pricing.

It is worth considering provision of a regulated futures/forward market that is coordinated with the spot market. This would give benefits to retailers and generators in terms of their prudential requirements and provide for better transparency for regulators as to market performance.

18. *What are your views on the assessment of generators' and retailers' profits?*

We do not see evidence of excessive profits being made in the sector. The market is sufficiently open to new entry to protect from long term attempts to use market power to generate excess profits.

That is not to say that participants cannot benefit or suffer detriment from structural supply and demand changes or regulatory change. The emissions trading scheme is an example where generators with existing renewable assets will be materially benefit as carbon price increases through time, increasing the cost to thermal generators who set the marginal price through their generation offers. Other potential structural drivers of benefits/detriments include (but are not limited to):

- Tiwai point closure
- rising demand from electric vehicles
- competition from solar PV
- price of thermal fuel supplies

Structural changes to the market will lead to changes in wholesale price that are important in providing signals to consumers and investors.

The process undertaken to change the Crown Minerals Act gives generators cause to take stock however of the risks they are exposed to when making long term capital investments.

Transmission

19. *What are your views on the process, timing and fairness aspects of the transmission pricing methodology?*

No comment.

Distribution

20. *What are your views on the assessment of distributors' profits?*

While the distributors' profits are monitored by the Commerce Commission, there is less transparency over the efficiency of their operating expenses and capital expenditure. It seems likely that NZ Inc. is failing to capture economies of scale overall in the acquisition of core network assets such as conductors, transformers, poles etc.

The Commerce Commission should have the power to compare the relative operating costs and capital expenditure of different distributors and apply caps or such limits on outliers. While all networks have different geographical and topographical challenges to work with, appropriate adjustments can be made to identify possible outliers.

In cases where distributors, or their owners, have invested in non-regulated activities it has been difficult if not impossible for external parties to unravel the level of investment in these activities and the costs involved. Even where the investment is made by the Trust entities that are owners distribution companies or a company that owns the distribution entity, it is not unusual to find the distributors management fully immersed in the decision making process.

It is understandable therefore that the Trustees and Board controlling community owned distributors in general appear to have little accountability in practice to the community for success or otherwise of the commercial decisions they make.

21. *What are your views on the assessment of barriers to greater efficiency for distributors?*

The greatest barrier is likely the lack of coordination and control required to bring networks together to realise the benefits of economies of scale. We note Professor George Yarrow's conclusion that there is no convincing international evidence of economies of scale in distribution, but in response, point out that in Europe there is a very large and competitive engineering sector ready to service electricity distributors of all sizes. In New Zealand, because of its small size and isolation, the number of suppliers and their resources are much more limited and the ability of distributors to obtain lowest cost equipment and services is much reduced.

While the report by TDB Advisory that provides a statistical analysis of comparative network costs shows that it would be wrong to assume that simply merging distributors will result in reduced operating costs; from a retailers perspective it is apparent that on average, larger distributors are easier to work with and create fewer problems on a per ICP basis.

Existing ownership structures and the resistance of communities to devolve control beyond their own sphere of influence make it most unlikely that there will be any significant rationalisation of distributors or their operations in the absence of any direction from Government.

22. *What are your views on the assessment of the allocation of distribution costs?*

The assessment helps inform the debate and illustrates that there is no perfect answer to the allocation of distribution costs. It is also apparent that there are some outliers and there is some room movement to reduce the costs to residential consumers.

This type of analysis illustrates the benefits of comparing the pricing structures between different distributors and how the Commerce Commission could use such measures for better identifying underperforming distributors.

23. *What are your views on the assessment of challenges facing electricity distribution?*

Introduction of cost reflective tariffs has to be the priority for distributors because it needs to precede the expected growth in the number of consumers investing in PV generation and batteries. Otherwise there is a risk of massive inefficient investment by consumers and growing problems with voltage management on low voltage networks.

The impact of cost reflective tariffs on disadvantaged consumers also needs to be considered as they may well incur higher costs than more well off consumers who can shift their load more successfully.

Summary of feedback on Part four

24. *Please summarise your key points on Part four.*

There is no evidence that the wholesale market is not working effectively and efficiently. The electricity market has delivered substantial investment in generation and much of that new investment has been in renewables which has seen older less efficient thermal plant retired or replaced with more efficient plant.

The market has also facilitated the entry of new retailers which has resulted in innovation, lower prices and more choice for consumers in all regions.

To interfere in the wholesale market structure to any great extent puts at risk the ability and appetite for investors to respond to price signals and future market conditions.

The large number of distributors is having a direct cost impact on retailers, slowing up retail competition, and having a direct cost to consumers in terms of lack of economies of scale. That is unlikely to change without Government intervention.

Solutions to issues and concerns raised in Part four

25. Please briefly describe any potential solutions to the issues and concerns raised in Part four.

While we believe that the market structure fundamentally sound we believe that that there is always room for improvement. Areas we suggest could be improved include:

Retail

- Government to target households that experience energy hardship through access to Energy Assistance tariffs that are tendered for by Government.
- Consider capping prompt payment discounts (but not eliminating them)
- Enabling retailers and distribution to adopt default UoSA's to reduce barriers to entry.
- Landlords to carry legal responsibility for costs associated with vacant premises
- Withdraw Fair Trading Act amendments re: "no door knocking" as it is not pro-competitive. Consider extending existing protections available for consumers under the Act from unfair and misleading conduct if necessary.

Distribution

- The Commerce Commission should be more active in comparing distribution company costs to ensure that the benefits of coordination between distribution companies are maximized.

Wholesale

- Continue to monitor performance of ASX futures and OTC contracts market
- Consider provision of a regulated futures/forward market that is coordinated with the spot market. This would give benefits to retailers and generators in terms of prudential requirements and provide for better transparency for regulators as to market performance.

While Nova has suggested several options to be considered as a part of this review process we believe that any change should be subject to good governance process including consultation to ensure that the change does not result in unintended outcomes, exacerbate poor outcomes for consumers or act to work against other Government policy objectives, and in particular, objectives related to lowering emissions.

Part five: Technology and regulation

Technology

26. *What are your views on the assessment of the impact of technology on consumers and the electricity industry?*

The key issue arising from new technologies is that there is no certainty on which technologies will be taken up most rapidly or have the most impact on consumers net electricity demand. The market needs the flexibility to adapt and respond, as do regulators if New Zealand is to make the most of the opportunities and avoid misallocation of investments and market distortions.

It also seems likely that the opportunities that new technologies will provide consumers with will also increase complexity. In that context, it will be important to both ensure consumers receive the right market pricing signals, but also that disadvantaged consumers do not miss out entirely on the benefits of new developments or perversely that consumers that cannot afford to adopt new technologies are made worse off as a result.

27. *What are you views on the assessment of the impact of technology on pricing mechanisms and the fairness of prices?*

It is critical that distributors remove cross-subsidization of consumers who can afford to adopt new technologies. If that is not achieved, then within a few years then there is a risk of capital being wasted on PV and new technologies in situations where their benefits are less than break even against their true economic cost.

28. *What are your views on how emerging technology will affect security of supply, resilience and prices?*

A market based industry structure in our view is the best mechanism enabling new technologies to be developed, deployed and integrated into our power system in a way that an efficient and effective manner.

In theory at least an expansion of distributed generation should enable greater system resilience, but the extent to which this is achieved in practice will depend somewhat on how the distributors incorporate these technologies into their networks.

It is unclear and remains to be seen what the net impact will be on market price levels and volatility given the interdependence of PV costs, battery costs, timing of EV charging, and consumer responses to market signals.

It is likely that the complexity of technology will result in increased difficulty for all consumers except for the most technologically savvy to understand which energy solutions best fit their circumstances. In this regard, energy advisors may play an important role in the uptake of technology and we believe this is one area that Government can assist through agencies such as the Electricity Authority, MBIE, and EECA as well as industry organisations such as ERANZ.

Regulation

29. *What are your views on the assessment of the place of environmental sustainability and fairness in the regulatory system?*

Todd believes that environmental sustainability has a place in the regulatory system and supports the Government's overarching goal to reduce New Zealand's carbon emissions. It has submitted its views on how policy can best meet that goal whilst balancing the need to attract ongoing investment, maintain investor confidence and positively impact on innovation and development of low emissions technology. These submissions were in the context of the Zero Carbon Bill, the Emissions Trading Scheme and the Crown Minerals (Petroleum) Amendment Bill. The concept of fairness is already enshrined in New Zealand's Consumer Protection laws, most notably in the most recent amendments on unfair contract terms in the Fair Trading Act 1986.

It is important the that Electricity Authority retains its objective to promote competition in, reliable supply by, and the efficient operation of, the New Zealand electricity industry for the long-term benefit of consumers. If environmental sustainability and/or fairness are added to this, then as was experienced with the original Electricity Commission, the Board becomes laboured with making judgments between alternatives that are best made in the political sphere, or at least at Government policy level.

30. *What are your views on the assessment of low fixed charge tariff regulations?*

Nova agrees with the analysis that the low fixed charge tariff is distortionary in its outcomes for consumers. The regulations are more likely to harm those in need of assistance than help and should be removed.

Targeted assistance measures would be of more use to consumers that are experiencing hardship.

31. *What are your views on the assessment of gaps or overlaps between the regulators?*

There are advantages and disadvantages in the current structure and the alternative of a larger merged regulator.

There is perhaps too greater a weight under the Commerce Act given to the commonality between different monopoly services, i.e. electricity and gas distributors, Transpower, airports and telecoms. While many of the same principles may apply between these sectors, the Commerce Commission should perhaps be given greater discretion to undertake comparative analysis of electricity distributors.

32. *What are your views on the assessment of whether the regulatory framework and regulators' workplans enable new technologies and business models to emerge?*

It is appropriate for regulators to anticipate change and endeavor to ensure that regulations do not hinder new developments, but nor should they be allowed to access indirect subsidies, such as those currently being realised by domestic solar PV systems through reduced distribution charges.

33. *What are your views on the assessment of other matters for the regulatory framework?*

Summary of feedback on Part five

34. *Please summarise your key points on Part five*.

Solutions to issues and concerns raised in Part five

35. *Please briefly describe any potential solutions to the issues and concerns raised in Part five.*

The Low fixed charge regulations should be removed as per Question 30 and more targeted measures adopted to assist those experiencing energy hardship.

Additional information

36. *Please briefly provide any additional information or comment you would like to include in your submission.*