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Power of Together

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Electricity Price Review

C/- Ministry of Business Innovation and Employment

To whom it may concern

Re: Electricity Price Review - Options Paper submission

Our submission set out below highlights a recent and material change in the wholesale supply and pricing of electricity in New Zealand (which is now significantly above electricity prices in Australia), and proposes a solution we believe would be easy to implement at minimal cost.

We also comment on the issue of win backs and finally include some comments on distributors and their costs to consumers.

1. **Reinforcing Wholesale Market Competition**

   We are disappointed the Committee has decided not to recommend prohibiting vertical integrated companies. Here's why:

   When we entered this industry in April 2017 as a retailer, we were able to purchase electricity at wholesale rates via the SPOT market and/or the ASX Futures market.

   There is now no longer a wholesale market for electricity in New Zealand.

   Since September 2018 we have been unable to access electricity at wholesale rates. The market makers (the gentailers) are now charging prices via the SPOT market and the ASX Futures market at above retail rates, that is the rate at which they sell to their retail customers and the price they use to compete with us for new customer acquisition and "win backs".

   The average ASX Futures price at Otahuhu for 2019 is now (as at 22 March 2019) $157.33 MW. The average for the period Jan 2020 to Dec 2022 is now at $113.72 MW

   Yet gentailers are selling to new customers and "win-back" customers at prices considerably below this. If we give the gentailers (which are primarily State owned and operated companies) the benefit of the doubt that they are not selling below cost and thereby engaging in uncompetitive and predatory pricing activity, then the implied price of generation that their retail arm is receiving is just $73.50 MW (this is the average implied margin based on published pricing on the switchme web site as at 15 March 2019 for 4 major gentailers).

This implied amount of $73.50 MW for the retail arm of a gentailer does not include special offer cost, for example one retailer is currently offering a months free power ($200+ pe annum), others are offering cash credits on the consumers first bill of $50 to $300. If these costs were included in this analysis then the implied price would be even lower.

Also if any margin for the gentailers retail operations was included then the implied cost of generation for the retail arm of these gentailers would be even lower still.

When we recently asked a gentailer why we as a new entrant retailer were no longer able to buy from gentailers at wholesale prices (wholesale being defined as buying in bulk to then on sell in smaller parcels at a profit), we were told that this is, and I quote: ***"an advantage we enjoy being an integrated retailer".***

The result of new entrant retailers like us now having to pay above retail rates for product supply has created a significant barrier to entry for anyone planning to enter this market place as a retailer (without generation of their own) and means we can no longer compete with the incumbent gentailers on their new customer and "win-back" pricing.

This is not a short-term issue non-generating retailers are facing. Wholesale prices offered on the ASX Futures market for the period Mar 2019 to Dec 2022 now average $113.72 MW. When time of day and losses are allowed for (an additional 5%) the actual cost non-gentailers would pay for the electricity their customers use would be $119.40 MW.

Yet gentailers are selling at an implied cost of $73.50 and possibly even lower than this. How can gentailers sell below the actual cost of electricity? The answer is they are not. The wholesale market prices, the prices offered by the market makers (the gentailers), is totally unrelated to the cost of supply.

Being an integrated retailer means that a gentailers retail arm can sell to its customers below the cost of the wholesale rate for electricity because its generation division is receiving the higher wholesale price for its product.

Non gentailers do have the opportunity to do this.

Based on current wholesale prices (as at 21 March 2019) as per the ASX Futures market for the period 2019 – 2022 generators will receive an average of $113.72 MW for their product. The gentailers retail operation will pay approx. $119.40 for this product after allowing for time of day use and losses (an additional 5% allowance).

The gentailers retail arm will therefore make a loss of -$49.50 MW when selling at $73.50 MW when competing with new entrant retailers. However the gentailer as a whole (combined generation and retail) will report margins, before cost of generation, of $67.82 MW.

If we assumed a 30% mark up on cost to produce then the implied cost to produce electricity would be $45.21 MW. This seems about right given New Zealand's mix of generation which is around 85% from renewables.

Of course not all of the gentailers retail customers are sold product at $73.50 MW, this pricing is reserved for competition with non-gentailers via new customer acquisition and win backs from new entrant retailers, the gentailers know new entrant retailers cannot compete with this price as this price is below the cost of the product gentailers sell to non-gentailers at.

Non-generators (new entrant retailers) do not have the opportunity to cross subsidise their retail business like this. Having to buy at wholesale and sell at retail use to produce a positive margin, this is no longer the case.

A comparison with Australia highlights the problem non-gentailers in New Zealand are now facing. The average ASX Futures price for the period 2019 – 2022 is now $113.72 in NZ, in Australia (for the same period) the average is $81.96 MW. NZ is now 38.75% higher than Australia.

If 2019 pricing is removed from this comparison New Zealand's average cost for 2020 – 2022 is still $99.18 MW compared to Australia's $78.34MW, still 26.6% higher and still well above gentailers selling at $73.50 MW.

Yet in response to a recent report into the New Zealand electricity market by Dr Stephen Poletti, a senior lecturer in energy economics at the University of Auckland Business School, Meridian Energy chief financial officer Paul Chambers had this to say:

"Wholesale prices are the same now as they were in 2004, retail competition is healthy, and residential prices are in the bottom third of the OECD and fully 40 per cent less than those in Australia, all while generating 85 per cent of our energy from renewable sources," he said. In Australia the renewable share is 15 per cent.

"New Zealand has a very secure supply of electricity, even in dry years for hydro generators,"

We understand from the Electricity Authority that a number of planned new entrants have put their entry into this market place on hold given the recent loss of a wholesale market for electricity supply.

We also understand that a number of existing retailers (without generation of their own) have recently been forced out of the market through the loss of product supply at wholesale prices.

We believe there is a fundamental design flaw in the electricity wholesale market that has allowed the incumbent gentailers to create a significant barrier to entry for any intending new entrants and is now being used to inflict above market rates on new entrant retailers, which has the potential to drive more non-gentailers from the market place.

When the current market structure was implemented there were only the incumbent gentailers operating in the market place. As a result of a perceived lack of competition new entrant retailers were encouraged to enter the market and product was made available at **wholesale** rates through wholesale markets (SPOT and ASX Futures) to facilities new entrant retailers.

Unfortunately in the original market design no provision was made on the generation and product supply fronts for new entrant retailers. All generation assets had been allocated to the incumbent gentailers and non were retained to provide a pool of product at wholesale prices for any new entrant retailers.

Since September 2018 there has no longer been a market place for the purchase of electricity at wholesale prices. The gentailers have forced up the price of electricity to non gentailers to the point where the wholesale rate is now above the retail rate at which the gentailers retail arm uses to compete with new entrant retailers. We understand from previous submissions to the Pricing Committee that some gentailers have win back success rates of 70%+. This should not be surprising given the considerable pricing advantage integrated gentailers enjoy.

We believe this is an abuse of the dominant position gentailers have in the generation market place and is unfair to new entrant retailers encouraged into the market place to provide competition.

We wish to point out that this situation is not a reflection of new entrant retailers inability to manage their risk, it is a direct result of the supply of product from the gentailers no longer being available to non-gentailers at wholesale prices.

Non-gentailers are being forced to buy at above the retail rate the gentailers compete at, there is nothing we can do about this and we are reliant on the regulatory bodies to protect us from this type of behaviour.

Prohibiting vertically integrated companies was one solution that we had hoped would lead to the fair access to product at the same price for all retailers. Similar to what has been achieved in the Telecommunications industry through the establishment of Chorus for the fibre network rollout.

Other solutions are available if the Committee does not support prohibiting vertically integrated companies. For example in the Dairy industry Fonterra is required to provide 15% of its product at cost to facilitate competition.

We believe a similar model would work well in the electricity industry, would be easy to implement, simple to administer and would impose little if any additional costs on the industry.

For example a percentage of the daily electricity generation could be allocated to non-gentailers. Allocation of this product amongst non-gentailers that do not expose customers to the SPOT market price (such retailers don't require access to product as the risk of high prices has been transferred to the end consumer) would be on a volume basis (market share) and could be managed by the Clearing Manager and incorporated into the existing reconciliation and settlement processes.

Setting the cost of this allocation would be relatively simply, there is access to costing information in the market place already including the gentailers published pricing on the switchme web site and the recent sale of 50 MW of electricity to Tiwai Point Aluminium Smelter by a consortium of gentailers.

To protect non-gentailers from the gentailers simply lowering their new customer and "win-back" pricing even further, in order to negate new entrant retailers gaining access to product at a true wholesale price, we believe gentailers should not be permitted to sell below cost and engage in predatory pricing activity.

We wold suggest the Electricity Authority be required to obtain and monitor all retailer pricing plans to ensure a fair and level playing field for all.

We believe consumers will benefit from such a regime. New entrant retailers would be able to operate and make investment decisions into product development and innovation in the knowledge that they are now operating on a level and fair playing field. Consumers will benefit through more competition and potentially lower prices. Forcing higher prices onto new entrant retailers as is happening at the moment, is only resulting is less competition and higher prices.

We believe such an allocation system can and should be implemented swiftly as the current wholesaling of electricity by gentailers to non-gentailers is unrelated to the true cost of producing electricity in New Zealand, even allowing for a percentage of New Zealand's supply to be generated from thermal sources.

Again, we wish to point out that this situation is not a reflection of new entrant retailers inability to manage their risk, it is a direct result of the supply of product from the gentailers no longer being available to non-gentailers at wholesale prices.

2. Increase Retail Competition – Prohibit win-backs

We applaud the Committee for making this recommendation, however the devil will be in the details as to how this will be monitored and enforced.

For example what constitutes a win-back? Currently gentailers accept a switch out immediately then engage with the customer and make an offer that is typically described by customers that switch to us as ***"too good to refuse"***

Is an offer within 30 days, 3 months or 24 months considered a win-back? Whatever time period is put in place we can all be sure that the losing retailer will target a win-back campaign based on this timeframe and will continue to be able to offer below cost rates to win back such customers (refer to point 1 above - **Reinforcing Wholesale Market Competition.**

Is the offer content considered a win-back? For example offer components not available to their existing customers such as cash credits on first bill, a month's free power, etc.? How will win-backs vs new customer acquisition and competitive activity be defined?

One way to ensure fairness for all customers would be to mandate that a retailers pricing must be the same for all customer segments and for both new and existing customers on the same Distributors pricing plan.

For example why is a retailer permitted to charge excessive rates to one customer only to then offer a substantially lower rate to another customer on the same Distribution company pricing plan? Wouldn't it be fairer for the consumer to have access to the same pricing without having to research and negotiate this same rate?

Then there is the issue of automatic contract rollovers being used to prohibit a consumer switching from one retailer to another. We note the Committee is silent on this matter however we see this as being similar to the win-back situation in that it stops consumers choosing another retailer, inhibits competition and generally means the consumer is left paying a higher price than they would otherwise be paying.

One example we would like to share with the Committee is this:
A small business operator wished to switch to us on a lower rate. The incumbent gentailer advised the consumer they could not unless they paid a $400 break fee due to having had their contract automatically rolled over recently. The incumbent retailer claimed the customer had failed to "opt out" of a recent email notice of this contract rollover.

This consumer was left having to pay a much higher price than they would have with us and a much higher price than that which the incumbent is offering to other customers on the same Distribution company pricing plan.

And the subject line in the email from the gentailer to the consumer was: ***"(Retailer name) empowering electricity freedom".*** A statement the customer described as being *"cynical"*.

In addition to banning win-backs and in fairness to consumers, we urge the Committee to also ban automatic contract rollovers. Consumers should have to opt in to a new contract not opt out of an automatic rollover.

We would also recommend the establishment of a whistle-blower regime where staff of any industry participant (generator, retailer or distributor) would be able to report inappropriate and uncompetitive information and/or behaviour that is deemed to be illegal, unethical or not correct within an organisation that is either private or public.

3. Distribution Companies

The Committee makes mention that its brief was to include fairness and wellbeing and in particular electricity hardship in its assessment and recommendations yet we note the committee does not recommend the merging of Distribution companies.

The Committee references both The Lines Company and Northland areas as areas of high energy hardship and in need of assistance.

The Committee acknowledges these areas have a higher Distribution cost per consumer when compared to other areas throughout the county and states that the average priced paid by a The Lines Company consumer in 2018 using 7,500 kWhs a year (low user plan as below 8,000 kWhs) was $2,765.35.

A similar consumer in Auckland using the same amount of electricity would pay approx. $2,030.09 (based on a gentailers published pricing on the switchme site).

That's a 36% premium for not being part of a larger consumer base across a Distributors area.

If The Lines Company and Top Energy distribution companies were merged with Vector in Auckland and all consumers paid the same price then the Auckland consumers would pay approx. $53 a year more (an increase of +2.6%) while The Lines Company and Top Energy consumers would pay approx. $682 a year less (a saving of 36%). And this is without removing the local areas dividend/discount back to community trusts and ultimately to consumers and without allowing for any efficiencies and cost savings from such a merger.

Local management and resources could still be maintained, this is just about taking the total costs and applying them evenly to consumers across a larger consumer base to even out the distribution costs.

Wouldn't this be a fairer model? User pays simply doesn't work in areas where there is a large geographical area and limited population and leads to energy hardship. Perhaps the Committee could survey consumers throughout the country on having a fairer system where we all pay the same Distribution company charges. We believe the majority of New Zealanders would opt for such a model.

This is not to say that Top Energy or The Lines Company are poorly run or inefficient, its simple highlights the material downside to having separate Distribution companies with such large discrepancies in consumer numbers over which to spread the costs of distribution, which results in higher prices for end consumers in certain areas.

Thank you for your consideration.

Yours sincerely

Russell Just

On behalf of Plus Energy trading as Community Power.