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Electricity Authority Market Development Advisory Group

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Consultation on the Market Development Advisory Group's Paper: Price discovery in a renewables-based electricity system

1. Executive Summary

1.1. The Consumer Advocacy Council (the Council) **recommends** that the Market Development Advisory Group (MDAG) advises the Electricity Authority (the Authority) to:

- a. Treat consumers as significant and active stakeholders in the industry.
- b. Investigate and report on whether the current wholesale market model is fit for purpose to meet consumers' needs and deliver a fairly priced and reliable electricity supply.
- c. Consider incentives to ensure sufficient new renewable generation can enter the wholesale electricity market.
- d. Consider and promote the indicators outlined in point 3.10 in its assessments of the market.
- e. Focus on limiting charges to consumers.
- f. Ensure generator/retailer companies ('gentailers') do not profit from a broken system.
- g. Encourage the industry to develop mechanisms that help consumers understand and respond to price signals.
- h. Ensure that retailers provide consumers with the opportunity to respond to price signals.
- i. Require industry to consult directly with consumers, rather than using retailers or distributors as proxies.
- j. Ensure that industry recognises its role in providing consumers with reliable information, so they are well-informed about their options and the benefits and costs of these options.

2. Introduction

- 2.1. Thank you for the opportunity to make a submission on *Consultation on the Market Development Advisory Group's Options Paper – Price Discovery in a Renewables-Based Electricity System, March 2023* (Issues Paper).
- 2.2. This submission is from the Consumer Advocacy Council (the Council), the independent advocate for residential and small business electricity consumers (consumers) in Aotearoa New Zealand.
- 2.3. Electricity is an essential service and is needed to support health and wellbeing. Most New Zealanders need electricity to heat, cool and light their homes, cook, shower, run appliances, provide safety and security measures, maintain hygiene, and increasingly power new technology, such as electric vehicles.
- 2.4. Fair pricing of this essential service is critical. Many residential and small business consumers have limited ability to change their electricity demand in response to price rises. It is therefore crucial that the market settings ensure sufficient generation and that prices are not driven by generators seeking significant profit or returns for their shareholders.
- 2.5. The Council has confined its comments to the main issues in the Issues Paper that impact consumers.
- 2.6. The Council highlights the amended statutory objectives (as of 31 December 2022) of the Authority, set out in section 15 of the Electricity Industry Act 2010 (the Act):
 - “(1) The main objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.*
 - “(2) The additional objective of the Authority is to protect the interests of domestic consumers and small business consumers in relation to the supply of electricity to those consumers.*
 - “(3) The additional objective applies only to the Authority's activities in relation to the dealings of industry participants with domestic consumers and small business consumers.”*
- 2.7. In addition, section 16 of the Act states that one of the functions of the Authority is:
 - “(ia) to undertake measures aimed at protecting the interests of domestic consumers and small business consumers in relation to the supply of electricity to those consumers ...”*
- 2.8. The Council notes that the Issues Paper is extensive. However, it is largely industry-centred at the expense of the needs and rights of the consumer.
- 2.9. Consumers, including large consumers, pay all costs associated with electricity generation, transmission, electricity distribution businesses (EDBs) and retail supply. Consumers should be considered active participants in the electricity network, not

simply a passive receiver of electricity, as they ultimately pay for all electricity generated and the supporting infrastructure.

- 2.10. In order to meet the above objectives around long-term consumer benefit, the Authority must treat consumers as what they are; significant, active stakeholders in the electricity industry who provide the financial means and demand for the industry to operate.

Recommendation:

The Council recommends that MDAG advise the Authority to treat consumers as significant and active stakeholders in the industry.

3. Competition in the wholesale market

- 3.1. The Issues Paper recognises the current market model is flawed. It identifies the need to strengthen competition as a vital ingredient to successfully shift to a renewables-based system. New Zealand has utilised the ‘energy-only market’ model since its wholesale electricity market was established in 1996.
- 3.2. There are very few measures aimed at alleviating market power. The Council submits that the market is not working competitively to facilitate fair pricing or incentivise investment in new renewable generation to ensure demand capacity and reserves can be reliably met at all times.
- 3.3. Since 2018, electricity spot prices have generally remained well above the cost of new renewable supply. The persistently high prices indicate that the pricing methodology developed in 1996 and the Authority’s approach to promoting competition is no longer an effective mitigation against the exercise of market power.
- 3.4. As outlined in the Council’s previous submission on Wholesale Market Competition,¹ the market currently relies on a uniform marginal pricing mechanism that drives the spot price spikes and high forward prices. The market settings incentivise incumbent generators to delay investment in projects that would reduce prices.
- 3.5. We note the open letter dated 13 September 2022 sent by small retailers to the Authority outlining just some of these concerns.
- 3.6. Research on the wholesale market that we commissioned from the New Zealand Institute of Economic Research (NZIER) also notes issues faced by small players and new entrants:

“... the wholesale market volatility and the resulting lift in the futures price ... may have negatively affected new entrant retailers [that] could not obtain suitable bilateral arrangements to enable them to be competitive against the five gen-tailers [that] are vertically integrated. Analysis of EA’s data on trends in retail market share

¹ [Promoting competition in the wholesale electricity market in the transition towards 100% renewable electricity \(Consumer Advocacy Council, 2022\)](#)

and entry and exit shows that 14 retailers have left the electricity market since late 2018 and a number of other new entrant retailers have either not increased customer numbers or have reduced customer numbers.

... our analysis showed some signs of market power across the vertically integrated gentailers, as it has given them significant competitive advantage over other competitors ...

and created barriers for new entrants through self-hedging contracts ... This has consistently enabled them to obtain large short-term profits from the wholesale market. However, the increased number of grid emergency notices in the recent winter (NZ Herald 2022; RNZ 2022a) and Transpower's concerns about constrained generation capacity for the next two winters suggest that the gen-tailers are incentivised to make short-term profits and pay excessive dividends to shareholders rather than making long-term investment in new renewable generation. Ultimately, this comes at the cost of higher electricity bills for consumers, especially households and small businesses."

- 3.7. Small retailers do not have the same protection and are exposed to the risk associated with volatile spot prices and have difficulty obtaining adequate bilateral hedges. This hinders competition in the retail market.
- 3.8. Analysis indicates the market share of small and medium retailers has slowed in recent years. A number of new entrant retailers have either exited the market or are not able to increase or maintain their customer numbers.
- 3.9. Feedback given to the Authority as part of its own survey of electricity industry participants noted:

Perceptions of competition were low, with many respondents suggesting current high prices, and incumbents' established revenue streams to weather this, indicative of limited competition and barriers for new entrants. Some respondents also cited a lack of transparency over internal pricing for generator/retailer ("gentailer") companies.

- 3.10. The Council's view of indicators of a healthy, functioning and thriving market are:
 - a) A functioning market structure fosters competition and incentivises the allocation of resources towards more renewable generation.
 - b) There is sufficient supply to meet the increased demand for renewable electricity at any time, including periods of peak demand and dry years.
 - c) The price of electricity is fair and reasonable such that it is affordable by everyone, especially for those households and small businesses who are already facing energy hardship and/or having difficulties in keeping up with the increased costs in the current economic environment of high inflation and rising interest rates.
 - d) Encourages New Zealand to move toward decarbonisation.

- 3.11. The Council encourages the Authority to consider and promote these indicators in its assessments of the market. The Council understands these indicators to be a key diagnostic tool that accurately measures the health of the market. The Authority, in a sense, must broaden its toolbox to better investigate and preserve the health of the electricity market.
- 3.12. In doing this, it will serve the interests of smaller consumers who comprise a substantial portion of the market. It will also reflect the change in context from the competitive environment of 1996 when the current pricing methodology was introduced, to a less competitive environment.

Recommendations:

The Council recommends that MDAG advise the Authority to:

- a) investigate and report on whether the current wholesale market model is fit for purpose to meet consumers' needs and delivers a fairly priced and reliable electricity supply
- b) consider incentives to ensure sufficient new renewable generation can enter the wholesale electricity market
- c) consider and promote the indicators outlined in point 3.10 in its assessments of the market.

4. Higher prices are not beneficial to consumers

- 4.1. As outlined by the Authority, the electricity industry has a critical role to play in decarbonising the wider energy system. The electricity industry will be very different as it evolves towards the 2030 and 2050 climate change goals. It is vital that this transition is an equitable one, and that the consumer voice is considered throughout the process.
- 4.2. Decarbonisation of the industry is likely to be costly but consumer generation and distributed energy resources have the capacity to support an easier transition by facilitating more efficient usage of current resources while empowering the consumer. This can only happen if the regulatory arrangements support competition, availability of data, consumer access to services, and fairness to consumers.
- 4.3. In the immediate future, approximately 300,000 LPG and gas customers will need to seek alternative energy sources, necessitating a significant amount of generation to meet the resulting demand. Additionally, the increase in ownership of electric vehicles and new data centres will further fuel demand for electricity. The increase in demand cannot just be viewed by generators as a financial opportunity to take advantage of, rather than a call to action in improving baseload generation capacity.
- 4.4. In many cases, generators sell at fixed price contracts to retailers, which then sell at fixed price contracts to customers. High wholesale prices eventually flow into these prices. However, the price signals the Market Development Advisory Group (MDAG)

refers to in this paper do not get passed directly to consumers. Prices are ‘smeared’, removing some volatility but also limiting the ability of consumers to respond to price changes or adjust their own electricity demand to minimise price.

Recommendation:

The Council recommends that MDAG advise the Authority to focus on limiting charges to consumers.

5. Generators are profiting from a broken system

- 5.1. Many generators are being paid significantly more than their generation costs due to the way that final price is calculated. This creates significant windfall profits that are not necessarily reinvested in new generation and instead paid out to shareholders. We refer you to our submission on the ‘*Wholesale market review*’ for more information about how generators are profiting from a broken system.
- 5.2. This is a further sign of the failure of the existing market model to deliver a service that meets the long-term interests of consumers.

Recommendation:

The Council recommends that MDAG advise the Authority to ensure generator/retailer companies (‘gentailers’) don’t profit from a broken system.

6. Price signals are not transparent

- 6.1. Retailers must provide all consumers the opportunity to respond to price signals, and do this in their pricing directly with consumers, not through other stakeholders.
- 6.2. The Council disagrees with the statement in the Issues Paper that “volatility and high prices (in times of scarcity) in the wholesale market are, in fact, in the best long-term interest of consumers”. Increased volatility can be expected as renewable generation increases and it will negatively impact consumers unless the transition to 100 percent renewable generation is well managed.
- 6.3. The pricing strategies employed by retailers play a significant role in shaping consumer behaviour. It is not acceptable for retailers to rely on intermediaries to convey pricing information, as this can lead to confusion and miscommunication.
- 6.4. The Council expects the industry to be more proactive in helping consumers understand how changes in behaviour can save money. There is a responsibility on the part of retailers to upskill consumers and provide them with easy-to-understand information that they can respond to. The views of retailers and distributors are often treated as a proxy for consumers’ views – this is not appropriate, and consumers must be engaged with directly.

6.5. Access to customer metering data is important for consumers because access to data can help them benefit from pricing offers from retailers, load aggregators or network/s. We refer to our submission on '*Updating the regulatory settings for distribution networks*' for recommendations around metering and consumer access to data (recommendations 3 and 5).

Recommendations:

The Council recommends that MDAG advise the Authority to:

- a) encourage the industry to develop mechanisms that help consumers understand and respond to price signals
- b) ensure that retailers provide consumers with the opportunity to respond to price signals
- c) require industry to consult directly with consumers, rather than using retailers or distributors as proxies.

7. Consumer rights and education

- 7.1. Education of consumers is key. It is crucial that consumers are well-informed about their options for supplying power to the electricity system, so they can make informed purchasing, selling and operating decisions.
- 7.2. The Council refers the Authority to our previous submission on '*Updating the regulatory settings for distribution networks*' about the importance of ensuring consumers understand their obligations and the potential benefits of consumer-generated electricity.
- 7.3. Electricity is an essential service and that brings with it a social responsibility to educate. Increasing public confidence in the electricity system is at the core of this issue. This will require dedication from the industry to transparency, reducing complexity where possible, better explaining issues for consumers and listening to what consumers think and need.
- 7.4. The electricity sector has a responsibility to demystify itself for customers. Key issues such as price signals are important for consumers to have in mind and there is room for the Authority to take the lead on making these issues more transparent. This involves informing consumers what these issues involve and how they affect them.
- 7.5. There is an imbalance in the way that the burden of responsibility is placed on individual consumers, particularly those who have the least ability to make changes. It is unfair to expect small consumers to bear the brunt of the responsibility for changing their behaviour when the retail industry has the power to effect change on a much larger scale. Industry must step up.

Recommendation:

The Council recommends that MDAG advise the Authority to ensure that industry recognises its role in providing consumers with reliable information, so they are well-informed about their options, and the benefits and costs of these options.

8. Conclusion

8.1. We wish to thank the Authority for the opportunity to submit on this Issues Paper.

8.2. If you have any further queries regarding the submission, do not hesitate to contact Emma Sturfels – Principal Advisor Consumer Advocacy Council, on either emma.sturfels@cac.org.nz or 021 812 663.

Yours sincerely,



Deborah Hart

Chair

Consumer Advocacy Council