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Dear Miriam

### **Contact Energy submission on the first report into the electricity sector**

Thank you for the opportunity to provide feedback on the first report of the Electricity Pricing Review Panel (**Panel**) into the state of the electricity sector. We agree with the Panel's assessment that the electricity system is working well to produce reliable and sustainable electricity supply. Where it isn't working so well is for those customers who are struggling to pay all their household bills and we believe the government, the electricity industry and Contact can do more.

We trust that our submission highlights the positive action Contact has been taking and will continue to do so. There are many areas of the Panel's findings we agree with, others where we challenge the underlying data and, in some cases, we have provided alternative data and suggestions for the Panel to consider.

#### **Overview**

New Zealand has a world-class electricity system that is trusted by consumers and is the envy of much of the developed world. However, we accept there is always room for improvement. In identifying and making improvements it will be critical that decision-makers are aware of, and avoid, any unintended consequences.

#### **Price and Affordability**

Residential electricity prices have risen since 1990 but since 2014/2015, when the impact of the regulatory changes in the early part of the decade had settled, those prices have been flat. This has been achieved in an environment when the "pass-through" components of the customer's bill have continued to rise. This highlights the challenge of retailing electricity.

We fully expect the gross margin in retailing to continue to decline despite increasing efficiencies in the sector as technologies and the current regulatory development programme reduce barriers to entry. We also believe the projected electricity demand growth to be satisfied at wholesale prices no more than those observed over the last five years.

Contact agrees with the Panel that there is a group of vulnerable consumers who are struggling. This requires an appropriate social policy response by government. Well targeted policy responses will go some way to alleviating this issue and Contact is committed to the actions individually, and through our membership of the Electricity Retailers Association of New Zealand, to help vulnerable customers.

Our customers tell us they want choice, certainty and control which we satisfy with innovative products and services. The market is delivering and Contact's customers are able to access products such as weekly/fortnightly billing, SmoothPay and PrePay products, that have none of the traditional disadvantages of prepay, and better credit processes. We are proud of the work we are doing to ensure all customers have access to affordable energy and in the very near term will continue to release products, such as an un-discounted "no-frills" lowest tariff product.

### **Do the market settings need to change?**

The current market design has done an extraordinary job of delivering dynamic efficiency in the generation of electricity. The right investments have been delivered at the right time and the right place, and at the least cost to the consumer. Any major changes in direction should only be considered with great caution.

With 29 distribution networks, Contact has consistently argued standardisation is essential to minimise barriers and to encourage competition and innovation for the benefit of consumers. We believe there is no doubt that competition will produce the best outcomes for consumers.

The benefits of competition are evidenced by the extraordinary growth in retail competition. Suggestions the current market design impacts the ability of independent retailers to enter and grow their market share don't stack up. There are challenges to achieving scale, but they are no different to those in any competitive market.

Emerging technologies have the potential to increase security of supply and resilience (through a more distributed, decentralised, lower carbon power system) and reduce prices for consumers. In our view, the challenge to harnessing the benefits of new technology is creating price signals and markets that incentivise new technology investment when and where it is needed.


### **The future**

We are working with our customers, partners and suppliers to decarbonise New Zealand's energy sector. The decisions we make will go a long way to achieving New Zealand's decarbonisation goals but they require significant investment in new renewable energy. We would urge the Panel to ensure that any recommendations to change market settings take into consideration what they could mean for the necessary investment signals.

## Conclusion

Our submission provides a detailed explanation of the above and we look forward to discussing these views with the Panel in due course.

Yours sincerely

A handwritten signature in blue ink that reads "Dennis Barnes".

Dennis Barnes

**Chief Executive Officer**



# Electricity Price Review

## Summary of Feedback on Part Three

Contact's customers tell us they want choice, certainty and control, and today's competitive retail market has delivered these to an unprecedented level. Competition has encouraged retailers to compete vigorously on price and service, understand customers' needs and tailor product offerings accordingly, to a greater degree than at any time in history. Our evidence of this is that:

- Today, electricity customers enjoy an unprecedented level of tariff and retail provider choice, as well as a large array of fixed tariffs which provide certainty and control. This is evidenced both by Contact's tariff offerings expanding from 3 in 2014, to 10 today, as well as the number of retail companies growing from 11 in 2011 to 33 today;
- The voluntary rollout of smart meters – currently sitting at around 80% - has been a significant enabler;
- Independent surveys of consumer trust, net promoter scores, and customer complaints all point to a positive trajectory;
- The competitive environment has also placed downward pressure on the energy component of customer bills. Competition has compressed Contact's retail margins, with mass market margins reducing 9% since 2013. But, despite a highly competitive environment which has resulted in increased complexity, Contact's cost-to-serve has remained roughly constant at \$250 in real terms (well below the Panel's estimate) since 2010.
- The current falling costs of generation supply options (e.g., wind), as well as the new era of intensified competition for generation driven by reducing solar PV costs, points to the possibility that - if managed efficiently through the current wholesale market framework - there will be pressure on the energy component of prices.

Contact's promise to customers is to make a positive different to their lives and prosperity. We will find solutions for every household to have access to energy. We agree with the Panel's assertion that, despite the significant benefits enjoyed by most customers as a result of vibrant competition, there is a group of customers who are struggling. We agree, and, jointly with other electricity retailers, we commissioned PwC to help define the vulnerability challenge.

Our own efforts so far have:

- Reduced the average debt at disconnection by 35%, increased reconnection times, and reduced the costs of disconnection and reconnection.



- Launched a number of products which have features targeted at customers who are struggling to pay their bills.

Contact believes the issue of customer hardship is the most pressing issue the industry faces. In our view, the industry's response, in collaboration with government and social agencies, must be properly targeted at the essence of the problem. Poorly designed or broad-based interventions at any point of the electricity supply chain will have impacts across the whole market. This includes investment and thus security of supply; a critical factor that the market has delivered on, with substantially superior outcomes for consumers than the 30 years of government-driven investment that preceded it.

We encourage the Panel to recommend that policy makers define the problem of hardship and target a response carefully in order to not risk the significant benefits customers are enjoying as a result of the high level of competition in the retail sector, nor the efficiency of the whole supply chain.

## Solutions to issues and concerns raised in Part Three

Every customer's bill is a function of both their network tariff and their consumption levels. Figure 12 in the Panel's report showing the 'Impact of factors affecting consumption and price' clearly provides the signpost to the effective levers for impacting affordability. We would strongly recommend the Panel weight their recommendations for change to the factors that are most impactful to customers:

**Price:** Network prices are critical in determining the price paid by customers. Significant differentials in network prices are evident primarily due to location and population density.

**Consumption:** The quality of New Zealand's housing stock is key to reducing bills/improving affordability for customers.

In addition we will continue to find solutions for every household to have access to energy, including:

- Releasing products that have features targeted at helping those customers who are struggling e.g. SmoothPay, revamped PrePay, Weekly/fortnightly billing, No-Frills
- Improving our credit practices so customers incur less debt with us
- Equipping our customer service representatives with training and tools to help vulnerable customers

During a period of vibrant competition and downward pressure on the energy component of the bill we have improved outcomes for our customers. At the same time the monopoly network component of the bill has been steadily rising. The Panel could recommend that policy efforts are directed at how competition for distribution services could be strengthened and encouraged, so that, in the long run, we become less reliant on the blunt nature of monopoly regulation and we provide the optimal environment for incentives to innovate and compete.

## Summary of Feedback on Part Four

Our feedback on Part Four continues the theme that vibrant competition is delivering very real and tangible benefits to consumers. Ultimately, the cost of energy to the final consumer is driven by the cost of electricity supply. The wholesale market framework that was established in the 1990s, and has been evolving ever since:

- Has been stable and performed extraordinarily well, in the context of other capital-intensive industries and electricity markets globally;
- Has largely delivered the right investments at the right price and at the right time, in a way which has maintained security of supply;
- Has delivered a 46% decrease in electricity sector greenhouse gas emissions since 1999;
- Is demonstrating that average wholesale prices are being disciplined by the threat of entry of new plant; and
- As commented on previously, the prospect of intensified competition for generation (and networks) from distributed energy resources bodes well for the future.

Hence we generally we agree with the Panel's assessment of the performance of the generation sector. If the Panel remains uncertain of their initial conclusions, we direct them to the report that we, along with other market participants, commissioned from Adjunct Professor Grant Read. This report provides a comprehensive framework within which the Panel can assess the performance of the wholesale market, and respond to others' assertions that excessive rents are being made.

While some may assert that there are barriers to competition to retail, and/or that a "two tier" retail market is emerging, we express the following caution:

- The compression in retail margins for Contact, discussed above, counters any assertions that large, vertically integrated retailers are able to preserve historical profit levels through restricting competition;
- The sheer number of new retailers suggests that there are few, if any, inefficient barriers to *entry*;
- The growth in market share of new retailers suggests there are few barriers to *growth*, other than the reasonable costs of expansion that any small business would experience in an industry with the complexity of electricity;
- Contact supports the growth of the Tier II retailers by providing flexible contracting arrangements to independent retailers helping them grow market share. We currently provide independent retailers with approximately 300GWh of supply, this equates to 43,000 homes. These contracts are shaped to match the consumption of retail customers, permit nomination across a selection of regional locations and are priced against the ASX with a small margin to reflect credit risk and volume;
- Widening spreads in short-term hedging markets should only be a concern for the Panel if they believed that it was prudent for independent retailers to be carrying out the majority of their risk management activity at the last minute;

- The portion of Contact’s customer base which does not engage in switching appears to be an expression of their preference to not engage: our attempts to provide incentives to them to switch to alternative products traditionally have very low uptake.

This is not to say that improvements couldn’t be made (as is the case with any complex system in a changing environment). While 93% of available prompt payment discount was taken up by Contact’s customers, we are mindful of the current public discussion, and will launch a “no-frills” product which will provide the lowest tariff without a PPD component for customers who desire this.

## Solutions to issues and concerns raised in Part Four

The electricity supply chain – from fuel and generation to the customer – is highly interconnected and complex. Competition will drive the ultimate price paid by the consumer to the lowest price required to maintain security of supply, but, in electricity markets, this requires a high degree of complex coordination. Poorly designed interventions will have impacts along the full supply chain, and must be considered very carefully. But the following options for the Panel are worth considering:

- We believe there may be value in investigating how save and win-back activity could be disciplined. However, we believe that this should not be done in such a way that limits the benefits from a customer’s desire to shop around, as is the case in most workably competitive markets;
- The Electricity Authority’s IPAG group has considered in some detail, and will make recommendations, about how innovation and participation by consumers, especially those with distributed energy resources (DER), could be enhanced. Given the significant expertise that has been invested in that group, we encourage the Panel to engage proactively with the IPAG members to understand how this might be best achieved;
- Reducing barriers to retail competition, especially in non-urban areas, could be reduced further with distribution tariff standardisation;
- We suggest the Panel considers the decision of the Commerce Commission to use an above mid-point WACC when determining allowable revenues for distributors;
- The open letter from the Commerce Commission which highlighted the challenges of the electricity distribution businesses monopoly position and their role in emerging technology. The comment from the Commissioner, Sue Begg makes the point well “We need to ensure that consumers benefit from advances in technology, while at the same time promoting the development of competitive energy markets. Regulated monopolies should not have an unfair advantage over existing and future competitors in this space.”; and
- The Electricity Authority must get on and conclude a new Transmission Pricing Methodology.



## Summary of Feedback on Part Five:

Technology has a sizeable role to play in improving outcomes for consumers – the service they receive, the products that are capable of being offered, the cost of their power bill, the reliability they experience, and the decarbonisation of their energy supply chain.

There are examples, some highlighted by the Panel, where the regulatory framework designed in the past did not fully appreciate the impact of batteries, automation and control systems, demand response and distributed generation. We are now in a better place to understand these implications, which may in turn require some carefully considered amendments to regulations or industry Code:

- It now seems clear that the low user fixed charge regulations are no longer delivering to their original intent, and may actually be resulting in outcomes counter to that intent;
- The extent to which the regulatory framework (legislation, regulations and Code) facilitates effective competition for the supply of distributed generation and network services, needs to be considered
- The purview of existing regulators (the Commerce Commission and Electricity Authority) over driving greater efficiency into the distribution sector needs clarification before inefficient investment, that will ultimately cost consumers, is made under the existing regulatory regime.
- We do not believe that environmental sustainability and fairness should be introduced into the Electricity Authority's statutory objective, but the degree to which the wider regulatory framework delivers these is worth considering.
- Regulatory settings should not prejudice some consumer groups at the expense of others.

## Solutions to issues and concerns raised in Part Five

The existing regulatory work programmes can be adapted to deal with many of the issues raised by the Panel in the first report. We strongly encourage the Panel, that in making recommendations to implement the Panel's findings, it will be mindful of not duplicating existing work programmes but leveraging the capability, experience and knowledge that already sits within the industry's regulators.