

15 November 2019

Electricity Authority Board members
Electricity Authority
P O Box 10041
Wellington 6143

cc. James Stevenson-Wallace, Chief Executive, Electricity Authority
Hon Dr Megan Woods, Minister of Energy & Resources
Gareth Wilson, Principal Advisor, Ministry of Business, Innovation & Employment

By email

Dear Board,

Re: Follow-up on discussion at 14 November Board meeting

Thank you for the opportunity to present to you our evidence that the wholesale market has indeed broken down. We appreciate the inclination for the Authority to take extended periods of time to study such matters, and in many cases, we would agree it is prudent to do so, however, hopefully you now share our view that this particular issue requires immediate action.

Earlier opportunities to incorporate pure retailers' views, dating back to 2013, might have afforded slow progression and incremental improvement to the hedge market. However, it is clear now, based on the events since October 2018, that the related Code has not adapted well to the growth of retail competition. Severe unintended consequences, that were once speculated upon, are now borne-out. To that end, we respectfully request that, given the severity of the outcomes and the identifiable technical deficiencies of rules, the Authority and MBIE work together towards swift and transparent regulatory intervention.

To formally capture the essential elements of our presentation, see the summarised points below:

1. For more than 6 years, consumers have benefitted from pure retailers gaining market share through the reflection of a steadily improving LRMC and low volatility in the futures contracts market. This fell apart after the October 2018 spread perturbation and price spike. This should be taken as the primary direct reason for immediate intervention on spreads and liquidity, on its own.
2. With shifting market shares, toward pure retailers, we strongly believe that Gentailers are now too heavily invested in the absolute price set by market-making and have a fiduciary motive to inflate the futures price and restrict volume. Unaffordable futures, left unchecked, serve only to improve Gentailers profits and impede competition from those responsible for the consumer benefit stated above.
3. This will not fix itself without Gentailers' retail divisions becoming severally motivated to act in their own best interest, untethered to their generation interests. To that end, we believe that their retail divisions must be regulated to be transparent purchasers of hedges in the ASX, OTC, bilateral and physical generation markets. Strict (and auditable) prohibitions against self-

dealing, or fabricated self-dealing, would be easy to implement. We would be more than happy to have discussions on how to implement this quickly as many of our executives have deep experience in these matters. We believe that sanctions can be captured in existing anti-competitive regulations but we readily acknowledge that such regulations might also require appropriate enhancements.

4. The unanswered open interest at high prices needs to be reset without delay. To address this, we believe that this volume should be price capped at the proxy for LRMC. The length of time should be exactly equal to the length of time it would take to implement Gentailers' retailer independence outlined in item 3. A public announcement of the immediate intention to do so, to freeze trading, would also be a part of this solution.
5. Market making rules should be modified literally overnight. We recommend volume increases, spread restrictions to <1%, additional length to five years and peak period products be added.¹ These items could also coincide with the end of the price regulation period – outlined in item 4.
6. There is some debate regarding the “appearance of new costs” in the market post October 2018. We do not deny the Gentailers having the opportunity to recover these costs in real-time and long-term markets. What we do request is the Authority's diligence to ensure that these costs are not over collected by market manipulations, motives to constrain futures volumes, drive artificially high spreads or illiquid price levels. With a balancing of motives to ensure their retail acts in their own separate interest, we can confidently accept that the prices we hedge at are fair.
7. We seek a ‘no harm’ solution. We do not expect a special outcome for pure retailers, and we do not expect to negatively impact the fair value of the Gentailers' shareholdings. However, we do expect that excess profiting be reduced and consumers' interests be protected. We only expect the result that is always front and centre in the delivery of a fair and openly competitive market.

Finally, we feel it necessary to register our general dissatisfaction with the demonstrable lack of recognition pure retailers get from the Authority in our role in this market. We certainly do not believe we are engaged in an “experiment”² and we observe that the Authority readily concedes that regulations that keep Gentailers in check might reduce goodwill³ with those participants. We strongly believe that the goodwill of all participants should be weighed evenly, and any investment made to participate in this market, whether a pure retailer or a Gentailer, is equally important to the Authority entrusted to enact regulatory oversight.

It is worth acknowledging that while pure retailers may only serve 195,000 customers, we are likely responsible for nearly 100% of those consumers getting a better electricity price since 2010.

¹ A draft urgent Code amendment has been provided to Authority management.

² The Authority's consultation on saves and win-backs suggests that important market mechanisms enabled to encourage competition are an experiment. (paragraph 4.13 at <https://www.ea.govt.nz/dmsdocument/25988-saves-and-win-backs-code-amendment-consultation-paper-2019>)

³ Page 20 paragraph 5.12 of the Hedge Market Enhancements discussion paper at <https://www.ea.govt.nz/dmsdocument/26019-hedge-market-enhancements-discussion-paper>

We also respectfully request that a special process of consultation be initiated with haste. We have historically been set aside too easily in the formation of regulations. At this time, we sincerely implore that you change those past practices and involve us at every step of the way.

We look forward to hearing from the Board about your next steps.

Yours sincerely,

<p>Al Yates Chief Executive alyates@ecotricity.co.nz</p> 	<p>Luke Blincoe Chief Executive luke.blincoe@electrickiwi.co.nz</p> 	<p>David Goadby CEO & Founder david@energyclubnz.com</p> 
<p>Steve O'Connor Chief Executive Officer steve.oconnor@flickelectric.co.nz</p> 	<p>Gary Holden Chief Executive Officer gary.holden@pulseenergy.co.nz</p> 	<p>Emily Acland GM Regulatory emily.acland@vocusgroup.co.nz</p> 