



Saves and Winbacks Code Amendment – Consultation Paper

Submission to Electricity Authority

**PUBLIC VERSION**

21<sup>st</sup> November 2019

## INTRODUCTION

1. Vocus welcomes the opportunity to submit in relation to the Electricity Authority's Saves and Winbacks Code Amendment (S&W Amendment), 5 November 2019. Our submissions to MDAG and the Electricity Price Review<sup>1</sup> on this topic should also be treated as part of our submission.
2. If you would like any further information about the topics in our submission or have any queries about this submission, please contact:

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## VOCUS SUPPORTS INTRODUCTION OF A SAVES AND WINBACKS BAN

3. Vocus welcomes the Authority acting with relative urgency to consult on and adopt a ban on saves and winbacks.
4. We consider that, at this stage, the Authority's priority should be on implementing the ban on winbacks expeditiously. We agree with Electric Kiwi that there is no reason the reform couldn't be introduced before Christmas,<sup>2</sup> and note the Authority's latest, 22<sup>nd</sup> November 2019, Consultation Calendar anticipates a decision either in December or February.
5. We agree with the Authority's decision to reject MDAG's recommendations, and the reasons given for rejecting MDAG's recommendations. We also agree with Electric Kiwi's assessment of the MDAG advise<sup>3</sup> and note the MDAG Recommendations Paper included a large amount of material MDAG did not consult on.<sup>4</sup> We also agree with the Authority's implicit exclusion of the option to conduct a regional- based trial/experiment on application of winbacks ban.<sup>5</sup>
6. We agree with the Authority that the proposed Code amendment would: *"increase competitive pressure; innovation; customer acquisition and consumer search activity; reduce retail margins; and place retailers and their competitors on a more even competitive footing in terms of their knowledge of consumer characteristics"*.
7. The main benefit of the winback ban, which is not reflected in the Authority's assessment of its winback ban proposal, will be lower average prices and lower 'loyalty taxes' (which are presently estimated to be around \$500m per annum). The fact the Authority's assessment of the winback ban proposal largely omits the main benefit but is still strongly

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<sup>1</sup> Vocus, Submission on Electricity Price Review first report, 19 October 2018; in particular, paragraphs 22 – 41, at <https://www.mbie.govt.nz/dmsdocument/4235-vocus-group-electricity-price-review-first-report-submission>  
Vocus, Submission on Electricity Price Review Options Paper, 22 March 2019; in particular, paragraphs 4(c), 4(e), 6(a), and 7 – 10, at <https://www.mbie.govt.nz/dmsdocument/4932-vocus-submission-electricity-price-review-options-paper-pdf>

<sup>2</sup> Electric Kiwi, letter to the Electricity Authority, Electric Kiwi urges winback ban before Christmas, 10 October 2019.

<sup>3</sup> Ibid.

<sup>4</sup> Given the substantive changes to MDAG's analysis and reasoning, and the development of a new recommendation, it should have reconferred before finalising its advise to the Authority.

<sup>5</sup> The idea was floated in submission to the Electricity Price Review but did not gain any support.

positive reinforces our view that a ban is unambiguously to the long-term benefit of consumers.

8. The types of analysis other reviews of the two-tier retail market/saves and winbacks problem have undertaken, including on (i) the size of the 'loyalty tax', (ii) the extent to which the two-tier retail market has resulted in higher than otherwise average prices; and (iii) the distributional impacts (who is harmed), should be tested as part of the Authority's planned Post Implementation Review. We suggest the Authority reinstate, but also enhance, the residential savings calculation (a proxy for the loyalty taxes) on the EMI website to provide annual tracking of the size of the two-tier retail market problem.<sup>6</sup>

#### **VOCUS' COMMENTS ON THE PROPOSED SAVES AND WINBACKS BAN CODE AMENDMENT**

9. Vocus has the following comments in relation to the Authority's proposed Code amendment:
  - (i) We agree the ban on saves should be extended to all retailers and the current opt-in arrangements should be replaced.
  - (ii) We consider a 180 day ban on winbacks should be a minimum. Consistent with the approach in telecommunications we consider that the ban should be for an unlimited period. We are not aware of any issues with the experience in telecommunications sector which would suggest a time-limit would be appropriate or necessary. It may be useful for the Authority to obtain information on the age of winback activity. From Vocus' experience and observation, the losing retailers attempt winbacks years after they have a lost a customer.
  - (iii) We agree the ban should continue to apply when the customer changes retailer again or moves house. (How would the losing retailer know either of these things if it doesn't approach the customer to attempt a winback?)
  - (iv) We agree the winback ban should apply to third-parties so it cannot be circumvented.
  - (v) We would support the save/win-back protection scheme applying to all consumers.<sup>7</sup>

#### **OFFERING AN ENTICEMENT TO A CUSTOMER AS PART OF A GENERAL MARKETING CAMPAIGN**

10. We agree that the winback ban provisions should not interfere or preclude general marketing campaigns including, for example, contacting customers in Auckland via DM just letting them know about our new capabilities, or how good our service is and other

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<sup>6</sup> The Electricity Price Review Panel had some commentary on why the EMI calculations understate the size of loyalty taxes which could be taken into account.

<sup>7</sup> Refer, in particular, to our comments below under "The Authority's proposal should address mis-use of information", Our concerns about losing retailers (mis-)using information from the switching process or the lost customer's private contact information are not specific to residential customers.

general direct marketing activities such as a broad direct mailer that is not specifically targeting a customer that had switched. A simple, bright-line, test for whether marketing behaviour is acceptable could be whether or not the retailer used lost customer contact details that were obtained as a consequence of the customer being a previous customer of the retailer. This highlights the importance of the Authority adopting the Electricity Price Review direction that the winbacks ban should include specific restrictions on private customer information usage.

#### **CONDUCT PROVISIONS WARRANT FURTHER CONSIDERATION**

11. Vocus is not persuaded that the good conduct provisions are needed.
12. Vocus queries the need for provisions (11.15AC(2)(a)) prohibiting making statements or representations to a customer that are inaccurate, misleading, or deceptive; or likely to mislead or deceive etc. This is already covered by the Fair Trading Act.
13. We also consider that the restriction on communication any opinion that would be, or may be, likely to bring that other retailer's reputation into disrepute (11.15 AC(2)) goes too far. We should be able to tell a customer the truth, so if a competitor has failed in some way we are not precluded from raising this with our customers. The Authority should consider whether this provision should be removed or narrowed e.g. by deletion of "*or communicate any opinion,*" and/or narrowing the provision so it is clear that it applies only to the switching customer.

#### **THE AUTHORITY'S PROPOSAL SHOULD ADDRESS MIS-USE OF INFORMATION**

14. Vocus does not consider that the losing retailer should be able to use information from the switching system or the lost customer's private contact details for the purpose of saves and winbacks. We consider that use of information gives rise to issues of mis-use of information (information from the switching system should be used for the sole purpose of facilitating switching) and privacy concerns.
15. Vocus supports the Electricity Price Review's direction that the saves and winbacks ban "*would prevent a retailer from acting on any private information it held on former customers for marketing purposes. This would prevent retailers from sidestepping the ban by obtaining customers' prior agreement to retain private information after they are no longer a customer and using it for marketing purposes. We identified this as a loophole in the telecommunications rules. The ban, in combination with the Privacy Act 1993, would mean retailers could no longer make win-back offers based on switching notifications*".<sup>8</sup>
16. Electric Kiwi's proposed Code amendment<sup>9</sup> would address the issues the Electricity Price Review raised in full. Vocus considers that the Authority should adopt Electric Kiwi's

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<sup>8</sup> Electricity Price Review, Hikohiko Te Uira, Final Report, 21 May 2019, page 36.

<sup>9</sup> Electric Kiwi, letter to the Electricity Authority, Electric Kiwi urges winback ban before Christmas, 10 October 2019.

proposed Code amendment. This could be done either in conjunction with the Authority's own proposed Code amendment, or could be considered as an alternative option.

## **PROVISIONS ALLOWING RETAILERS TO COMMUNICATE WITH LOST CUSTOMERS COMES WITH RISKS THAT NEED TO BE MANAGED**

17. Vocus acknowledges there are legitimate circumstances in which a retailer may need to contact a customer it have lost or is in the process of losing, e.g. debt recovery, it is important to ensure that the provisions are proscribed in a way that minimises potential for abuse e.g.:
- (i) Each retailer should be required to provide an annual Compliance Certification by a company Director. There could also be obligations to disclose internal policies and restrictions on customer information usage to demonstrate how the saves and winbacks ban provisions are being complied with.
  - (ii) Restrictions could be included that staff who have customer sales and retention responsibilities cannot contact a losing customer under any of the 11.15AC(1) provisions.
  - (iii) The saves and winbacks provisions could specify the losing customers' contact information can not be used in order to "[offer] an enticement to a customer as part of a general marketing campaign" (see comments above on mis-use of information).
  - (iv) The losing retailer could be required to be able to demonstrate (e.g. recording of phone conversation) that the customer prompted the retailer to attempt to make a counter-offer and "persuade the customer to terminate the arrangement referred to in clause 11.15AB(2)".
  - (v) The Authority could automatically investigate where there have been abnormal levels of failed or reversed customer switches.

## **VOCUS AGREES WITH THE PROBLEMS THE AUTHORITY HAS IDENTIFIED**

18. The Authority had already established the 'problem definition' well in 2014. Subsequent reviews by the ACCC (Australia), CMA (in the UK) and the Electricity Price Review, as well as submissions made to MDAG, confirmed and provided quantitative evidence of the problem. Based on the Electricity Price Review the two-tier retail market/saves and winbacks is costing residential consumers about \$500m per annum.
19. We agree with the Authority's reconfirmation of the two-tier retail market/saves and winbacks problem, including that:

*"The existing arrangements mean saves and win-backs, in the Authority's view, are reducing retail competition and consumer welfare (well-being)."*

*"... saves and win-backs can effectively be used to stifle small [non-incumbent] retailers from acquiring customers and discourage potential entrants, thereby reducing competition".*

*“For small and new entrant retailers, saves and early win-backs can represent a barrier to entry and expansion.”*

*“By blunting the growth of competitors, such actions maintain or increase lifetime profit by large incumbents ...”*

*“... the retail market is highly concentrated and there are recurring concerns that saves and win-backs perpetuate this concentration.”*

*“... win-backs may be leading to inefficiently low customer acquisition by retailers and therefore insufficient retail competition.”*

*“... data from the post implementation review showed that win-back rates as a percentage of switches increased after the save protection scheme was implemented, suggesting that contractual provisions were not effective in blocking win-backs.”*

## **THE AUTHORITY HAD ALREADY DEFINED THE SAVES AND WINBACKS PROBLEM WELL IN 2014**

20. The Authority’s S&W Amendment consultation paper is supported by its original consultation paper on saves and win-backs in 2014. The two consultation papers offer consistent problem definitions which highlights that there is no need to ‘re-invent the wheel’. The critical difference between the two is that experience has shown banning saves, but not banning winbacks, simply results in an increase in winbacks to substitute for saves.

21. The S&W Amendment Consultation essentially and appropriately reconfirms the Authority’s 2014 position on the problem:

*“In most sectors, the incumbent supplier does not receive advance notice that a customer intends to change supplier. That information remains confidential to the customer and acquiring supplier until the switch is completed.*

*“By contrast, in the retail electricity market, the incumbent retailer is notified that a customer intends to switch before the process is completed. The incumbent may use this information to seek to ‘save’ the customer.*

*“The competitiveness of the retail market is driven in large part by acquisition activity and the threat of acquisition activity. Saves make acquisition activity less rewarding, because a proportion of customers cancel their switch before it is complete. Further, saves have a disproportionate effect on the profitability of acquisition activity, because they reduce benefits without reducing campaign costs. The same issue arises in relation to early win-backs.*

*“For small and new entrant retailers, saves and early win-backs present a barrier to entry and expansion. The effect on profitability is greater for such retailers as the costs of an acquisition campaign have to be spread across a smaller (or nonexistent) customer base.*

*“In some other sectors where retailers receive advance notice of impending customer switch decisions (such as New Zealand telephone landlines), saves are disallowed.”<sup>10</sup> [emphasis added]*

## **THE AUTHORITY SHOULD HAVE REGARD TO RELEVANT ELECTRICITY PRICE REVIEW SUBMISSIONS**

22. It is clear there was substantially higher engagement on the two-tier retail market/saves and win-backs issue in response to the Electricity Price Review than there was in relation to the MDAG consultation.<sup>11</sup>

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<sup>10</sup> Electricity Authority, Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Executive Summary

<sup>11</sup> MDAG were clearly incorrect when they claimed: “Many of the submissions to the report of the Electricity Price Review’s Expert Advisory Panel did raise matters of relevance to MDAG’s review but none of these were, in our view, differed [sic] substantially from information provided directly to MDAG”.

23. Submissions to the Electricity Price Review bolstered support for our concerns about the two-tier retail market (saves and winbacks). The joint independent retailer to the Authority on its 2019/20 work priorities noted:<sup>12</sup>

*"A number of stakeholders raised concerns about the saves and winbacks issue that had not engaged with the Electricity Authority/MDAG process, including the Commerce Commission, energyclubnz, ENA, Northpower, Top Energy, and Vector. For example, ENA has acknowledged "concerns that 'saves' and 'win-backs' are an impediment to full and effective retail competition and consumer switching", while Northpower and Top Energy advocate restricting winbacks for 60 days after a residential consumer switches retailer.*

*"The stakeholder submissions included concerns, consistent with our own, about the dominance of large incumbent retailers on MDAG. Vector noted that "Although we welcome the EA's investigation of the impact of win-backs, we are concerned that on this and other issues, they are unduly influenced by the large incumbent players. We note that there are currently no independent retailers represented on the MDAG, which has been tasked with investigating win-backs". ENA made similar comments.*

*"The Electricity Price Review submissions highlight the incumbent retailer defense of the two-tier retail market (saves and winbacks) is becoming increasingly isolated. The only submission supporting the incumbent retailers' views was from Sapare. While the Sapare report was submitted by Business NZ, it was funded by the gentailers (Sapare is one of Meridian's main consultants), and was not representative of members of the Business Energy Council."*

24. Our submission to the Electricity Price Review noted *"The Electricity Authority Advisory Group's, MDAG, position that saves and winbacks isn't a problem is out of step with not only the Panel, but also the ACCC and the UK Competition and Markets Authority (CMA)"* and *"A simple test to determine whether win-backs are to the long-term benefit of consumers is to ask whether they result in higher or lower average residential prices. The UK CMA asked itself this question, looking at a broad range of industries, and concluded win-backs resulted in higher overall prices. MDAG has ignored such matters in its consideration of win-backs which has meant it has ignored the main two-tier retail market problem a ban on win-backs would help address"* [footnotes removed].
25. The UK Competition & Markets Authority (CMA) investigation into a 'Loyalty penalty' super-complaint<sup>13</sup> looked into concerns that people who stay with their provider can end up paying significantly more than new customers, following a super-complaint from Citizens Advice into this matter.
26. The CMA investigation provided relevant new information to the two-tier market/saves and win-backs issue which we note MDAG has not considered or referred to in its Recommendations Paper. Nor did the MDAG Recommendations Paper contain consideration of the CMA recommendations, including 'name and shame' (through disclosure of loyal penalties), as well as initiatives such as collective switching.
27. We agree with the CMA that *"Regulators need to recognise the scale of the loyalty penalty and its impact in their markets, and to design effective interventions that help those consumers who are most in need, particularly the vulnerable"*.<sup>14</sup> We also agree with the Government response that *"It is essential that competition works for the benefit of consumers and that unfair practices are tackled effectively"* and *"Your analysis, confirming that done by Citizen's Advice, that the cumulative size of the loyalty penalty is*

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<sup>12</sup> Electric Kiwi, Flick Electric, Pulse Energy and Switch Utilities (Vocus), Joint submission from independent retailers – indicative work programme for 2019/20, 6 December 2018.

<sup>13</sup> <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

<sup>14</sup> CMA, Loyalty penalty update: getting better and fairer deals, 19 June 2019, at: [https://assets.publishing.service.gov.uk/media/5d08f9daed915d42ea95ddb4/Progress\\_update\\_June2019\\_31916\\_.pdf](https://assets.publishing.service.gov.uk/media/5d08f9daed915d42ea95ddb4/Progress_update_June2019_31916_.pdf)

in the region of £4 billion every year in the five markets you looked at indicates the scale of the challenge".<sup>15</sup> By comparison the Expert Advisory Panel has assessed that the loyalty tax for residential electricity in New Zealand is \$500 million and of a much greater scale to the concerns assessed in the UK markets.

28. The CMA investigation is particularly relevant because the matters the CMA looked into are precisely the types of matters that MDAG ignored or excluded from its saves and winbacks review:

CMA position on two-tier retail market/loyalty taxes	MDAG position/review scope
<i>The loyalty penalty is of greatest concern when:</i>	
<ul style="list-style-type: none"> <li>• <i>It is particularly concerning when those that suffer are vulnerable, where they are unable to act to avoid the penalty, or they are not aware of it.</i></li> </ul>	Treated as out of scope by MDAG.
<ul style="list-style-type: none"> <li>• <i>it involves confusing or misleading customers, leading to poor decision making or undermines trust in markets;</i></li> </ul>	
<ul style="list-style-type: none"> <li>• <i>market characteristics suggest it is likely to increase average prices for consumers;</i></li> </ul>	Despite this being central to the two-tier retail market/saves and win-backs problem MDAG failed to look at or attempt to determine whether saves and win-backs increased average prices for consumers (loyalty taxes).
<ul style="list-style-type: none"> <li>• <i>it leads to harmful distributional effects;</i></li> </ul>	Treated as out of scope by MDAG.
<ul style="list-style-type: none"> <li>• <i>the product or service is considered 'essential' or constitutes a large proportion of people's expenditure.</i></li> </ul>	Not raised by MDAG despite electricity being an essential service.
<p><i>Robust estimates of the loyalty penalty in different markets are of clear value to regulators. It would help them to decide which markets they should investigate further and enable them to evaluate the impact of their interventions on the size of the loyalty penalty over time or for particular groups of consumers.</i></p>	As noted above, MDAG failed to look at or attempt to determine whether save and win-backs resulted in loyalty taxes. Not only that but the Electricity Authority stopped calculating residential savings on its EMI website when this was used by submitters as an estimate of loyalty taxes, despite the Authority data highlighting that loyalty taxes were growing rapidly in size.

29. Vocus considers that the CMA investigation provides useful guidance in terms of the matters which should be tested as part of the Authority's planned Post Implementation Review. The Authority should establish (i) the size of the 'loyalty tax', (ii) the extent to which the two-tier retail market has resulted in higher than otherwise average prices; and (iii) the distributional impacts (who is harmed) and track how this changes after the winback ban is put in place.

<sup>15</sup> Letter from The Rt Hon Greg Clark MP, Secretary of State, Department for Business, Energy & Industrial Strategy to Dr Andrea Coscelli, Chief Executive, Competition and Markets Authority, Tackling the loyalty penalty, 17 June 2019, at: <https://www.gov.uk/government/publications/competition-and-markets-authority-loyalty-penalty-investigation-report-government-response>



29 June 2018

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## Submission on Customer Acquisition, Saves and Win-backs – Draft Issues Paper

Dear James,

1. Vocus welcomes the opportunity to engage with MDAG on the draft issues paper on Customer Acquisition, Saves and Win-Backs.
2. Vocus is concerned that although the Electricity Authority had identified why the scheme was ineffective at resolving the established regulatory failure<sup>1 2</sup>, the MDAG Issues Paper tends to relitigate the existence of regulatory failure and not why the current scheme failed to address the regulatory failure.
3. In the Electricity Authority review of Saves and Win-backs, the Electricity Authority correctly identified some of the problems with the scheme.
4. For example, the Electricity Authority noted “*the scheme changed retail behaviour to accelerate save protected switches; this allowed retailers to avoid the prohibition on saves and to subsequently win customers back after the switch was completed. **This behaviour change is likely to have affected the effectiveness of the scheme**”<sup>3</sup>*
5. The Electricity Authority further identified that “*As retailers can substitute between saves and win-backs relatively easily, we consider that **saves and win-backs need to be considered in total rather than separately in any future development of this scheme**”<sup>4</sup>*
6. The Electricity Authority also noted that small entrant retailers need input to the design, when they stated that “*Further analysis of how the scheme affected smaller entrant retailers could also help inform the regulatory design*”<sup>5</sup>
7. Despite our concerns about the direction of the issues paper and its questions, we still address those questions and have mapped our responses to your questions in Appendix 1.

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<sup>1</sup> Consultation paper saves and Win-backs (24 June 2014)

<sup>2</sup> MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Page 5;

<sup>3</sup> Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Executive Summary Para. 5

<sup>4</sup> Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.4

<sup>5</sup> Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para.13.9

## The established regulatory failure

8. We believe it is important to reiterate the underlying problem the scheme sought to address, in order to understand why the scheme was unsuccessful. The original Electricity Authority consultation paper on saves and win-backs summarised the problem well as: -

*“In most sectors, the incumbent supplier does not receive advance notice that a customer intends to change supplier. That information remains confidential to the customer and acquiring supplier until the switch is completed.*

*By contrast, in the retail electricity market, **the incumbent retailer is notified that a customer intends to switch before the process is completed.** The incumbent may use this information to seek to ‘save’ the customer.*

*The competitiveness of the retail market is driven in large part by acquisition activity and the **threat of acquisition activity.** Saves make acquisition activity less rewarding, because a proportion of customers cancel their switch before it is complete. Further, saves have a **disproportionate effect on the profitability of acquisition activity, because they reduce benefits without reducing campaign costs.** The same issue arises in relation to early win-backs.*

*For small and new entrant retailers, **saves and early win-backs present a barrier to entry and expansion.** The effect on profitability is greater for such retailers as the costs of an acquisition campaign have to be spread across a smaller (or non-existent) customer base.*

*In some other sectors where retailers receive advance notice of impending customer switch decisions (such as New Zealand telephone landlines), saves are disallowed.”<sup>6</sup>*

9. Further, the Electricity Authority decisions and reasons paper set out the intended benefits of restricting saves: -

*“(a) facilitate retail competition and innovation, by **reducing undue barriers to the entry and expansion of independent retailers** and the expansion of existing retailers*

*(b) support the durability of the competitive retail market.”<sup>7</sup>*

and that

*“Allowing retailers to opt for protection from retailer initiated saves will **reduce these barriers, and will remove the advantage conferred on the losing retailer** by providing them with information in the switching process.”<sup>8</sup>*

The decisions paper further noted that restricting saves would “increasing the incentive for retailers to **pre-emptively offer their existing customers a better deal.**”<sup>9</sup>

## The power industry is particularly prone to not offering ‘non-switchers’ a better deal

<sup>6</sup> Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Executive Summary

<sup>7</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.2.1

<sup>8</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.2.3

<sup>9</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.4

10. The MDAG identified in the issues paper<sup>10</sup> that 42% of residential ICPs have never switched over past sixteen years.
11. Combine the core 'non- switching base' with a number of factors and you have 42% of the base paying 'inflated' prices for their power. Key factors that combine to create the issue are: -
  - a) The ability of incumbents to exploit the current scheme, enabling winback levels unheard of in other industries (up to 40%), and as a result removing the benefit of competitive pressure on incumbents to right rate their existing customers – *"pre-emptively offer their existing customers a better deal"*, a key objective of the saves and winbacks scheme.
  - b) The rate of technology innovation - If you look at the telecommunications market, as a contrast, the rate of technology innovation means that incumbents do not collect 'inflated legacy price premiums' from existing customers. Technology innovation creates new services (such as Netflix) and in doing causes customers to service demands to change and as a result purchase a new service from their provider at the current market price or drives a customer to shop around. Examples of innovation in the telecommunications market include: -
    - a. The broadband market whereby consumers have moved from dial-up to ADSL, ADSL to VDSL and VDSL to Fibre. In the case of fibre 44% of all broadband users have already switched to new fibre services, at current market prices, in the last few years.
    - b. Similarly, in the mobile market the level of consumer handset innovation means consumers replace existing handsets each year and the need to acquire a new handset naturally leads to shopping around for a better price plan at today's prices.
  - c) Power billing is hard to understand and current prices are not marketed above the line. The electricity market is made up of numerous distribution companies and price categories for different consumer types. Electricity billing is not intuitive to the average person. This makes it difficult for a consumer to compare their bill to that of another person.
  - d) Switching back to your previous retailer is easy in the electricity market as compared to other markets. In the broadband market by the time the losing service provider is aware of a switch the gaining service provider will already have arranged for modems to be set out and for physical work to be undertaken at the exchange for example.
12. Given these factors the rational behaviour of large incumbent is to focus marketing effort on retaining customers who are switching (and readily identified) through immediate retention activity rather than proactively right-rating their existing customer base.
13. The inevitable result is that the scheme has not achieved its original goals and incumbents continue to monopolise the market despite almost 40 new competitors trying to gain market share. The Electricity Authority's market statistics show that the market share of incumbent retailers over the 8 years from 2010 to 2018 has not materially changed.

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<sup>10</sup> MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Para. 4.3.3

RETAILER	MARKET SHARE MAY 2010	MARKET SHARE MAY 2018
Contact Energy	24.71%	19.82%
Genesis Energy	26.36%	23.98%
Mercury Energy	22.11%	18.58%
Meridian Energy	12.3%	13.78%
Trustpower	11.33%	12.10%
<b>Overall Share</b>	<b>96.81%</b>	<b>88.26%</b>

Source: Market Share Trends - emi.ea.govt.nz

14. It appears that non-switching customers retained by these incumbents are on “inflated legacy price premiums” and that incumbents are using this to cross-subsidise offers to switching customers. For example, Powershop, a wholly owned subsidiary of Meridian Energy (a large incumbent retailer) noted that

*“existing retailers can and do [have different tiers of pricing for sticky and price-sensitive customers], because a negative pricing movement among the whole of a relevant segment of its customer base is significantly more expensive than just making [save offers] available to a few hundred customers”<sup>11</sup>*

#### Early notification of switching remains a regulatory failure under the current scheme

15. The current scheme was built on the presumption that win-backs (other than those almost immediately after a switch) would be harder than saves<sup>12</sup>. We have outlined the problems with this assumption in the following table.

PROBLEM	DESCRIPTION
<b>The switching process is invisible to the customer</b>	The switching process is invisible to the customer, and a relationship with a new retailer is not bedded in until the first bill which usually arrives at least a month later. So an early winback is easy to undertake

<sup>11</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Powershop submission to Authority, Page 31.

<sup>12</sup> Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Para 3.6.2

**Switch completion is meaningless to a customer until the first bill is sent**

The presumption of the original Electricity Authority paper was that a customer may be more willing to cancel an in-progress switch than to reverse a completed switch.

However, in practice it's the first bill that 'cements' the new relationship.

Given there is nothing in the code which prohibits early win-backs prior to the first bill being sent a withdrawal post-switch is just as easy as a withdrawal pre-switch.

**Regulated saves are easily converted into unregulated win-backs**

It is worth noting that in general the losing trader controls the timing for the completion of the switch as they must send the relevant completion file.

This gives a losing trader enormous power to subvert the regulated period by simply completing switches faster, only to withdraw it immediately after a successful save. Unsurprisingly, this is exactly what the MDAG has noted has happened<sup>13</sup>.

16. In the final decisions paper, the Electricity Authority also decided not to restrict early life win-backs. The Authority acknowledged that withdrawals could be used in win-backs within two months of the switch completion date in an undesirable manner but noted that retailers should not do this, stating that:

*"At present, win-backs within two months of the switch completion date can potentially be carried out using the switch withdrawal process. The Authority considers that this **is inconsistent with the original purpose** of allowing switches to be withdrawn after they are complete (which was **to correct switches that were carried out in error**) and is **undesirable**."*

*The Authority takes the view that retailers **should not withdraw a completed switch unless the original switch request was an error**. If the customer wishes to switch back to the original losing retailer after a completed switch— either because the original losing retailer persuaded them to do so (a win-back) or for some other reason – **then the original losing retailer should initiate a second switch**."<sup>14</sup>*

17. Despite this, the post implementation review shows that withdrawals are being used in this manner to effect win-backs. This has resulted in the situation that the Electricity Authority itself noted where "saves are substituted for win-backs relatively easily"<sup>15</sup> and that the "advantage conferred on the losing retailer remains"<sup>16</sup>.
18. Because of these issues, the results of the scheme cannot be used to assess if the regulatory failure itself existed, or continued to exist.

**Information won't address the issue - Incumbents will always win the perfect auction**

<sup>13</sup> MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Page 2 (Background)

<sup>14</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 4.2.7 and 4.2.8

<sup>15</sup> Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.4

<sup>16</sup> Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.6

19. The MDAG issues paper discusses information asymmetry. We consider it worth noting that greater information symmetry would do nothing to address the issue that 42% of residential ICPs who are paying higher prices and have never switched.
20. The incumbent retailers have deep pockets and the advantage of their non-switching customer bases to subsidise offers to switchers. This means that even with a perfect auction the incumbents will always have the upper hand.
21. The benefits of greater information symmetry are marginal and changes to increase the availability of information may only drive more cost into the industry.

### Contracts – the ‘Elephant in the Room’

22. We are concerned that the MDAG<sup>17</sup> and the Electricity Authority<sup>18</sup> have proposed fixed-term consumer contracts as a solution to a regulatory and market failure.
23. We strongly believe that driving the market to contracts an undesirable solution to the problem both for new entrant retailers and consumers. Because this is so frequently identified as a solution, we thought it important to address exactly why it is a rabbit-hole that should be avoided.

ISSUE	COMMENTARY
<b>Contracts make switching harder for consumers and drive costs and risk reputational damage into the industry</b>	<p>The industry has spent a great deal of time, money and resources on improving the switching process by making switching quick and simple for customers.</p> <p>More widespread use of contracts would mean that customers who are considering switching must now time their switching to occur only at the end of their contract – making switching harder.</p>
<b>Contracts discourage switching &amp; drive acquisition costs creating a barrier to entry</b>	<p>Incumbents have a significant advantage in brand recognition over most new entrant retailers. This means that until a new entrant becomes established and recognized in the market, a customer often perceives they are taking a risk when switching to a new entrant retailer.</p> <p>Having fixed term contracts as a necessity for a new entrant retailer means that fewer customers may be willing to take that risk, thereby lowering take-up and increasing acquisition costs, and creating a barrier to entry new entrants.</p>
<b>The perception of handcuffing consumers damages brands</b>	<p>Handcuffing customers to a retailer inevitably drives brand damage and consumer issues. New entrants who are trying to establish a brand are more impacted than better known established brands.</p>
<b>Contracting customers increases search costs</b>	<p>Small and new-entrant retailers will find that their search costs only increase as it becomes harder and harder to find uncontracted customers - creating a barrier to entry</p>
<b>Contracts make customers the loser in a</b>	<p>Fixed term contracts for the primary purpose of preventing early-life win-backs simply shifts the cost of the problem from the market to the customer</p>

<sup>17</sup> MDAG: Customer acquisition, saves and win-backs: issues paper, Para. 2.3.6

<sup>18</sup> Electricity Authority, Post implementation review of saves and winbacks Final Report (2017), Para. 2.4(c) and Para. 7.10 is one example among others.

<p><b>battle for market share</b></p>	<p>who will ultimately be penalized by early termination fees.</p> <p>We already see situations where a customer switches without realising they are already on a contract, end up on a contract with their new retailer as well, and are stuck in a situation where they must decide which contract they will break and to whom they will pay a now unavoidable termination fee.</p>
<p><b>Encouraging contracts does not achieve the Electricity Authority's statutory objectives</b></p>	<p>The Electricity Authority has a statutory objective of promoting competition for the long-term benefit of consumers. Encouraging fixed term contracts as a solution doesn't achieve these objectives for the reasons we have noted above.</p>

**Recommendations for further action**

24. In summary as the EA identified the previously established regulatory failure still exists, the problem simply morphing from saves to early winbacks. A large non-switching segment of residential customers are not benefitting from the competitive pressure and new entrants face significantly high acquisition costs due to 40% winback levels.

To address these concerns, we make the following recommendations to the Electricity Authority and MDAG on how to proceed

Recommendation 1: We recommend that the Authority regulate withdrawal activity

25. As outlined in paragraphs 14 to 17, the industry is using the withdrawal process in a manner which the Electricity Authority already noted is undesirable. We recommend that the Authority regulate withdrawals so that withdrawals are only used to address genuine errors and not to enable win-backs.

Recommendation 2: We recommend the Authority investigate pricing behaviour

26. In paragraphs 10 to 13 we outlined that it appears that the 42% of residential ICPs which have never switched are likely to be on higher pricing than customers who switch. We believe that it is likely there is a high spread of pricing between switchers and non-switchers, and many customers would be paying a legacy incumbent premium.
27. We strongly recommend that MDAG ask the Electricity Authority to undertake a review of consumer pricing, using its market monitoring powers, to investigate the price spread between switching and non-switching customers.
28. The end-goal of this investigation should be understanding the extent to which incumbents are keeping non-switching customers on high pricing and using this financial advantage to cross-subsidise retention activities on switchers.

Recommendation 3: We recommend the Authority regulate early life win-backs

29. We addressed the fact that use of contracts would be undesirable for both consumers and retailers in paragraphs 22 and 22. There appears to be no other meaningful strategies that small and new entrant retailers can use to counter early-life incumbent retailer win-backs.

30. This being the case, we recommend that the Electricity Authority extend the current scheme in the interim, in the form of a moratorium on win-backs for the first 45 days after a switch for retailers who elect to be save and win-back protected.

31. We have outlined how we believe this would meet the Electricity Authority code amendment principles in Appendix 2.

Regards,

Johnathan Eele  
**General Manager Commercial and Regulatory**  
**Vocus Group**



## Appendix 1: MDAG Issues Paper Questions

QUESTION	RESPONSE
1. Do some retailers have a distinct win-back advantage which others do not have and cannot ever have	
i. What sorts of strategies do acquiring retailers have to defend against win backs and how cost-effective are they?	<p>Acquiring retailers have very few strategies which can be used to defend against win-backs, and the only strategy of a meaningful nature is that the acquiring retailer can attempt to contract the customer.</p> <p>We believe that this is an ineffective and undesirable strategy, which we have elaborated on in some detail in paragraph 22/23 of this response.</p>
ii. Is there a market or regulatory failure preventing acquiring retailers using contractual terms to counter win-backs, given that some retailers are prepared to enforce contracts when customers leave them before the completion of the contract term?	We address this in paragraph 22/23 of this response.
iii. Does early switch notification give an undue advantage to retailers seeking to win-back customers.	Yes – see paragraph 15 - 18 of this response.
2. Are consumers frequently prompted into making decisions when they switch or switch back that are not in their best interests?	
i. If consumers make mistakes in the 'heat of the moment', is there a way to tell which was intended and which was the error – the switch or the win-back?	<p>Nothing within the current switching process or publicly available datasets would allow for this to be effectively analysed.</p> <p>It is however worth noting that, at least for domestic consumers, the Fair Trading Act cooldown period applies on any unsolicited sale which at face value does not seem to apply on a re-sign.</p>
ii. Is there any evidence that retailers have engaged systematically in proscribed marketing behaviours?	<p>Given we do not actively call customers who have withdrawn our switch, and that we are not aware of what is discussed with a customer during the retention call, it is difficult for us to collect evidence of this.</p> <p>We are anecdotally aware of questionable behaviour of certain sales agents during win-backs, including the provision of potentially misleading information, however when this has occurred we have raised this directly with the relevant retailers.</p>

		We suspect that, in general, retailers do not intentionally engage in illegal behaviour, but their agents may make statements which would be undesirable and would sit in a grey area.
iii.	Are there regulatory provisions that treat saves and win-backs in a different manner from other acquisition activity in such a way as to constitute a regulatory failure?	We address this in Paragraph 15 - 18 of this response.
iv.	What are the implications (if any) for consumers of saves and win-backs?	We address this in Paragraph 15 - 18 of this response.
3.	Are there any further issues related to saves and win-backs that we have not considered	Additional points that we believe the MDAG should consider are set out in the remainder of this response.

## Appendix 2: Assessment of proposed protection extension against code amendment principles

PRINCIPLE	COMMENTARY
<p>1. Lawful - The Electricity Authority and its advisory groups will only consider amendments to the Code that are lawful and that are consistent with the Act (and therefore consistent with the Electricity Authority's statutory objective and its obligations under the Act).</p>	<p>The Electricity Authority has already determined that intervening in retention activity is consistent with its objectives under the Act.</p> <p>Given that the original scheme differs only from this proposal in the presumption that the switching process influences customer behaviour, we believe that this proposal is consistent with the statutory objectives for all of the same reasons as supported the implementation of the current scheme.</p>
<p>2. Provides Clearly Identified Efficiency Gain or Market or Regulatory Failure</p>	<p>We believe that this proposal will meet the requirements of the principle for all of the reasons that the Electricity Authority set out in its original consultation and decision papers supporting the implementation of the current scheme.</p>
<p>3. Net Benefits are Quantified</p>	<p>We anticipate that the net benefits would align that the Electricity Authority had anticipated in its original consultation and decision papers supporting the implementation of the current scheme.</p>
<p>4. Preference for small scale 'trial and error options'</p>	<p>The proposal meets this requirement because:</p> <ol style="list-style-type: none"> <li>a. The proposal is that the Electricity Authority implement this on a trial-basis for a fixed (but extendible) period to determine the difference between the effects of the current scheme and the effects of what we believe is a more effective scheme.</li> <li>b. The scheme can easily be reversed if there are detrimental impacts by code amendment.</li> </ol>
<p>5. Preference for greater competition</p>	<p>The proposed amendment would be likely to encourage competition by:</p> <ol style="list-style-type: none"> <li>1. Allowing new-entrant retailers to become better established in the market and reduce the barriers to entry</li> <li>2. Encourages incumbent retailers to actively right-rate their customer base, as they would be at greater risk of losing customers on uncompetitive prices without the ability to rely on retention behaviour to reverse losses.</li> </ol>
<p>6. Preference for market solutions</p>	<p>The proposed solution is a market solution.</p>

7. Preference for opt-out features

The proposed amendment should still allow a retailer to opt-out of save and win-back protection and if they do so they will continue to be able to apply save and win-back strategies on other retailers who are also unprotected.

8. Preference for non-prescriptive options

Each retailer will be able to choose whether the value of save and win-back protection is sufficient to justify forgoing the ability to carry out saves and win-backs themselves.

14<sup>th</sup> August 2018

James Moulder  
MDAG Chair  
c/- Electricity Authority  
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PO Box 10041  
Wellington 6143  
New Zealand

**BY EMAIL ONLY**  
mdag@ea.govt.nz

## Cross Submission - Customer Acquisition, Saves and Win-backs Issues Paper

Dear James,

1. Vocus welcomes the opportunity to comment on the submissions of other respondents.
2. Despite having considered the submissions of other parties, including those from incumbent retailers, we continue to strongly hold the view that regulatory and market failures do exist, and that a moratorium on all save and win back activity is the best solution to these failures.
3. Vocus would like to reiterate its previous recommendations, as outlined in Sections 24 – 31 of our original submission, which is that:
  - a. The Authority should regulate withdrawal activity
  - b. The Authority should investigate pricing behaviour, with a focus to determine whether there is a high spread in pricing between switchers and non-switchers, resulting in a “legacy incumbent premium” for non-switchers.
  - c. The Authority should regulate early-life win-back activity.
4. We respond to specific commentary from other respondents in the table below

RESPONDANT(S)	COMMENT	RESPONSE
Genesis Energy	“All retailers, irrespective of size, have the opportunity to participant in saves and win-back.” <sup>1</sup>	Vocus believes it is important to keep the context of current market distribution in mind when considering the view that all retailers “have the opportunity” to participate in saves and win-backs.  <b><u>A small number of incumbent retailers retain 89% of market share,</u></b> and as such these retailers have an enhanced ability to compete against the small segment of switching customers.
Nova	“An early switch notification enables retailers to respond by seeking to retain customers. This facility is available to all participating traders” <sup>2</sup>	
Mercury	“Mercury does not believe an advantage exists. Retailers have different business strategies, value propositions, and service offerings and make decisions based upon the objectives they wish to achieve” <sup>3</sup>	

<sup>1</sup> Genesis Energy Submission, Appendix A, Response to Q1, First Paragraph

<sup>2</sup> Nova Submission, Table Responding to MDAG Questions, Response to Q1.3

<sup>3</sup> Mercury Submission, Page 3, First Question and Response

		<p>when competing on the “switching” segment.</p> <p>As such, all retailers do not have the ability to participate <u>equally</u> in saves and win-backs, and some retailers have <u>distinct advantages</u> when engaging in save and win-back activity.</p>
Genesis Energy	<p>“... to a customer save and win-back are the same and any distinction between the two is likely to be nonsensical to them.”<sup>4</sup></p>	<p>We agree, as addressed in our original submission it is <u>not sensible to try and draw a distinction between saves and win-backs</u></p>
Meridian/Powershop	<p>“From Meridian’s/Powershop’s standpoint, win-backs are clearly distinguishable from saves and the Authority’s original reasons for excluding win-backs from the saves protection scheme remain valid”.<sup>5</sup></p> <p>“... We share the MDAG’s view that the deferred timeframes for win-backs distinguishes these activities from saves and that, as a consequence, there is no apparent advantage for losing retailers”<sup>6</sup></p>	<p>Vocus disagrees with this view.</p> <p>As noted by Genesis itself above, and as outlined in some detail in Section 15 of our original submission, saves and win-backs are indistinguishable to the customer.</p> <p>Briefly reiterating the points raised in our submission:</p> <ul style="list-style-type: none"> <li>• <u>The switching process is invisible to customers</u></li> <li>• <u>Switch completion is meaningless to a customer until the first bill is sent</u></li> <li>• <u>Regulated saves are easily converted to unregulated win-backs</u></li> </ul>
Genesis Energy	<p>“The only way to tell if a customer made a mistake in the ‘heat of the moment’ is to speak directly with the customer, whether this be through win-back or through the acquiring retailer re-contacting the customer post win-back. Therefore, win-back is providing a key source of discipline on competitive offers and its removal could risk more switching being predicated on incorrect or misleading information to the detriment of customers”<sup>7</sup></p>	<p>Vocus disagrees with this view.</p> <p><u>In most markets, the losing retailer would not receive any notification</u> that a customer had changed service provider, and there has been no evidence presented by the retailers presenting these views that markets either having a prohibition on win-backs or no ability to identify customers to win-back are more prone to misleading information being presented to customers.</p>
Meridian/Powershop	<p>“Consistent with past submissions, we remain of the view that more permissible arrangements, pre the</p>	<p><b>Monitoring the sales behaviour of other retailers could also be monitored through other methods,</b></p>

<sup>4</sup> Genesis Energy Submission, Appendix A, Response to Q1, Second Paragraph

<sup>5</sup> Meridian/Powershop Submission, Paragraph Six Page 1

<sup>6</sup> Meridian/Powershop Submission, Appendix A, Response to Q1(iii)

<sup>7</sup> Genesis Energy Submission, Appendix A, Response to Q2, First Paragraph

	<p>saves protection scheme, enabled retailers to discuss / clarify alternative offers – providing, in doing so, an important “check” on retailer practices. Consideration of this is needed in assessing consumer impacts overall.”<sup>8</sup></p>	<p>particularly if one retailer had suspicions of proscribed behaviour being undertaken by another retailer, for example by a process equivalent to “mystery shopping”. Also the Utilities Disputes and the Commerce Commission can act.</p>
<p>Genesis Energy</p>	<p>“We further believe that the scheme has added confusion for customers due to the false distinction between save and win-back, which only refers to timings in the ICP switching process and is meaningless to a customer. Consequently, we now have different rules for customers depending on whether they have gas or electricity driving complexity and reducing transparency when we communicate with customers. This can be further complicated if customers also have telecommunications services or bundled consumer electronics with their retailer...”<sup>9</sup></p>	<p>Vocus disagrees with this view.</p> <p>As Genesis itself noted in its own commentary, some customers will have non-Gas services such as telecommunication services with their electricity retailer.</p> <p>There are already different rules in relation to saves and win-backs between telecommunications and electricity segments.</p> <p>Additionally, <b>the gas market is significantly smaller</b> than the electricity market, with the gas industry having only 283,227 ICPs<sup>10</sup> compared to the electricity markets 2,122,438 ICPs<sup>11</sup></p> <p>We do not agree it is reasonable to rely on <b>a much smaller market</b> to justify a lack of regulation on the larger electricity market.</p> <p>It is worth considering that there is already a range of different regulatory frameworks and rules in different markets, which is a reality any participant accepts and must manage when they choose to operate simultaneously in two or more independent markets and this should not preclude a regulator in one market from addressing issues affecting their market.</p>
<p>Mercury</p>	<p>“Mercury cannot comment on whether [early switch notification gives an undue advantage] in other industries however there is no advantage in receiving early notification of a switch where it relates to win-back customers</p>	<p>Vocus disagrees with the view that win-back activity is unrelated to switch notification.</p> <p>This view could only be sustainable in a situation where there was a regulatory prohibition against the use of switching</p>

<sup>8</sup> Meridian/Powershop Submission, Appendix A, Response to Q2(iv)

<sup>9</sup> Genesis Energy Submission, Appendix A, Response to Q3

<sup>10</sup> GIC Statistics – July 18 (<http://gasindustry.co.nz/work-programmes/switching-and-registry/current-arrangements/reports/>)

<sup>11</sup> Electricity Registry Statistics – July 18 ([www.electricityregistry.co.nz](http://www.electricityregistry.co.nz) – under Inquiries > Statistics)

	<p>as the win back actions take place post switch.”<sup>12</sup></p>	<p>information at all in business decision making for saves and win-backs.</p> <p>As we addressed in our previous submission (and as noted earlier, as identified by Genesis Energy) there is no clear distinction between a save and win-back.</p> <p>The current regulatory framework <b><u>allows an incumbent retailer to easily convert a save into a win-back</u></b> by completing a switch and then withdrawing it. As such, there is no reason to believe the win-backs are predominantly driven by anything other than switching activity.</p> <p>Further, the fact that post-switch withdrawals increased as pre-switch withdrawals decreased only reinforces the view that one was exchanged for the other and both were driven by switching notifications.</p>
<p>Entrust</p>	<p>“The Issues Paper asserts the sort of price discrimination we are seeing ‘can be beneficial for consumers overall if customers who pay lower prices are, on average, more price sensitive than those who pay higher prices’.</p> <p>If the Government wanted to downplay problems in the petrol industry it could, similarly, have suggested Kapiti Coast motorists might be more price sensitive than Wellingtonian motorists.</p> <p>Over-representation of low income and elderly consumers in the “stayer” category makes the suggestion “stayers” are less price sensitive implausible. The Issues Paper’s position would basically require a ‘reverse Robin Hood’ and for robbing the poor to give to the rich to be desirable and efficient. The opposite can be reasonably expected.</p> <p>A robust and inquisitorial review would recognise that whether the price discrimination is beneficial or exploitive and inefficient is critical to the problem definition, and test this with quantified evidence.<sup>13</sup></p>	<p>Vocus strongly agrees with Entrust’s position, which clearly identifies some of the concerns raised by Vocus and others on the direction and potential underlying biases of the original MDAG paper.</p>

<sup>12</sup> Mercury Submission, Page 3, Fourth Question and Response

<sup>13</sup> Entrust Submission, Section entitled “The sort of price discrimination we are seeing isn’t efficient or beneficial”



<p>Entrust</p>	<p>“Entrust would like to see the next stage of the S&amp;W review answer the following questions:</p> <ul style="list-style-type: none"> <li>• What is the level of price discrimination by incumbent retailers between “stayers” and “switchers”?</li> <li>• What evidence is there about the price elasticity (“sensitivity”) of demand of “stayers” and “switchers” and what does this mean for the “efficient” level (and direction) of price discrimination? How does the make-up of stayers predominantly low income and elderly) impact on this?</li> <li>• What level of excess returns have incumbent retailers been able to extract from “stayers”? How has this money been used?</li> <li>• Have incumbent retailers’ responses to competition for “switchers” resulted in higher prices to “stayers” to compensate for loss in revenue?</li> <li>• Was the Electricity Authority correct when it stated the switching process gave incumbent retailers an undue informational advantage for saves and early winbacks?”<sup>14</sup></li> </ul>	<p>Vocus agrees with the next steps identified by Entrust, which align with our own recommendations.</p>
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5. Vocus looks forward to engaging further with MDAG and the Electricity Authority on these matters.

We do however note that the most recent available project milestones from May 2018 do not have any specified end date for final analysis of submissions or suggested next steps to be proposed to the Electricity Authority board.

Given the potentially significant impacts of current market arrangements, we ask that MDAG urgently move to publish a final timeline for completion of this review and that the Authority move to the next stage of consulting on any intended regulatory changes, or further data collection activities, as soon as practical.

Regards,

Johnathan Eele  
**General Manager Commercial and Regulatory**  
**Vocus Group**

<sup>14</sup> Entrust submission, Section entitled “Questions that should be answered to establish the extent of the problem”

# VOCUS

19<sup>th</sup> October 2018

## ABOUT VOCUS

1. Vocus New Zealand is the third largest fixed line telecommunications operator employing over 800 staff in New Zealand. Our retail operation includes a number of challenger brands - Slingshot, Orcon, Flip, CallPlus and 2Talk. We are also an active wholesaler of telecommunications services including access, voice and broadband over both fibre and copper.
2. Vocus has made significant investments in New Zealand. We are the largest copper unbundler with a presence in over 200 exchanges throughout New Zealand. In addition we operate 4,200km fibre optic network transits between virtually all major towns and cities, and connects directly into all major peering exchanges.
3. Our 200,000+ customers in New Zealand range from government agencies, integrators, large corporate, SME and residential households. We are committed to New Zealand's fibre future.
4. Vocus is committed to New Zealand and is one of the few large NZ telecommunications companies to base all its customer service call centres here in New Zealand rather than outsourcing its customer service operations overseas.
5. Vocus is one of the fastest growing telecommunications companies in Australasia and a major provider of voice, broadband, domestic and international connectivity and data centers throughout New Zealand and Australia.
6. Vocus bought New Zealand electricity retailer Switch Utilities in December 2015 and since May 2016 has retailed electricity under the Slingshot, Orcon, Vocus and Switch Utilities brands. During this time Vocus has acquired some 16,000 ICPs through various marketing channels and upselling to our telecommunications customer base.
7. Thank you for the opportunity to make this submission. If you would like any further information about the topics in this submission or have any queries about the submission, please contact:

Johnathan Eele  
General Manager Commercial and Regulatory  
Vocus Group (NZ)

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19 October 2018

Miriam R Dean CNZM QC  
Chair  
Expert Advisory Panel  
Electricity Price Review  
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## **Submission on Electricity Price Review first report**

Dear Miriam,

1. Vocus welcomes the opportunity to submit at an early stage in the Electricity Price Review process, while the Advisory Panel thinking and analysis is still tentative. We appreciated the opportunity to meet and discuss our views on 21 September and look forward to future meetings and engagement as the review progresses.
2. Vocus supports the attention competition issues have been given in the first report.
3. Electricity networks are already price regulated, so improving competition will likely be the most productive avenue available to the Advisory Panel for delivering more affordable electricity.
4. The focus of our submission is on issues relating to how the large incumbent retailers are detrimental to the development of competition. This reflects where the barriers to competition and gaining scale predominantly lie in the electricity market.
5. Resolving the structural issues of market concentration and retail-wholesale vertical-integration, as well as related problems with contract market liquidity, and the two-tier retail market, identified in the Panel Report, are key to achieving a healthy and vibrant competitive market.
6. Competition must exist at both the retail and wholesale levels for the best price outcomes for consumers to occur. Vocus believes a focus on the wholesale market is imperative to resolution of the core structural issues. Whilst wholesale market power reduced for a time it is becoming stronger again through tightening supply conditions, resulting in wholesale prices that are inefficient and high. This market power continues to effectively provide the generators with the ability to control retailer margins and protect the level of non-vertically integrated retail activity.
7. A more competitive electricity market would mean more affordable electricity for consumers and the opportunity for entrant retailers to compete on a more level playing-field. Vocus' interests are tightly aligned with consumer interests.

## The Electricity Price Review should be ambitious for New Zealand

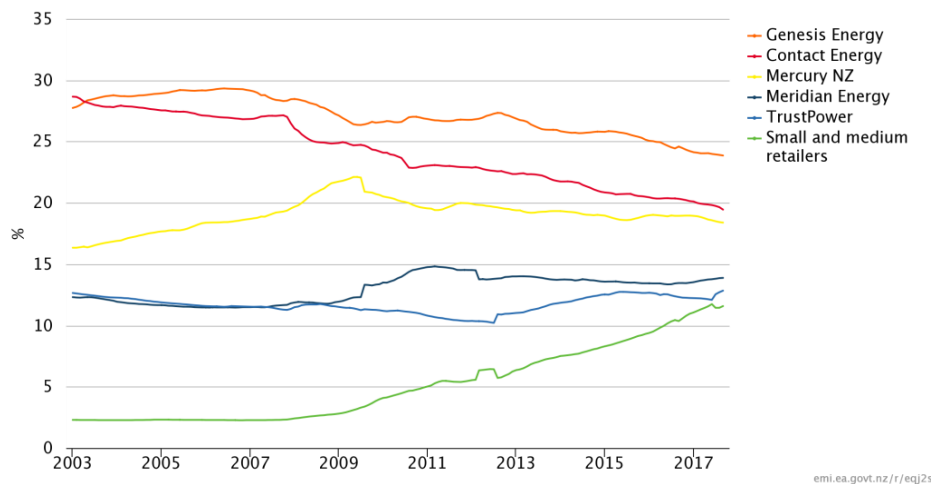
8. The incumbents continue to dominate the market. The Electricity Authority’s market statistics show the market share of incumbent retailers remains high, with only modest reductions since the last round of electricity reforms and the establishment of the Electricity Authority.

RETAILER	MARKET SHARE JAN 2003	MARKET SHARE OCT 2010	MARKET SHARE AUG 2018
Contact Energy	28.66%	24.3%	19.45%
Genesis Energy	27.74%	26.54%	23.86%
Mercury Energy	16.34%	20.72%	18.39%
Meridian Energy	12.31%	13.33%	13.88%
Trustpower	12.65%	11.27%	12.84%
<b>Overall Share</b>	<b>97.71%</b>	<b>96.16%</b>	<b>88.42%</b>

Source: Market Share Trends - emi.ea.govt.nz

9. The rate of change has been slow.
10. It took until March 2010 for the small retailers to gain more than 3% market share, after remaining stagnant for a long period of time.<sup>1</sup> Even now the market share of the small retailers is still under 12%.

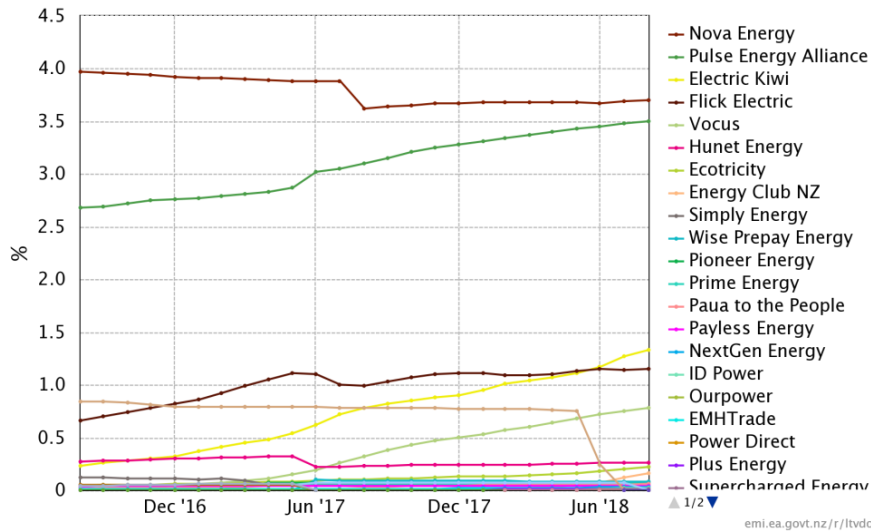
Electricity retail market share trends



<sup>1</sup> [https://www.emi.ea.govt.nz/Retail/Reports/R\\_MST\\_C?Grouping=T5&Percent=Y&\\_si=tg|market-structure,v|3](https://www.emi.ea.govt.nz/Retail/Reports/R_MST_C?Grouping=T5&Percent=Y&_si=tg|market-structure,v|3)

11. Vocus is one of the fastest growing new entrants, but our market share is about 1% after two years of being in the retail market. Electric Kiwi and Pulse have made similar inroads, while other new entrants have flatlined or gone backwards.<sup>2</sup>

Electricity retail market share trends, excluding the 5 large incumbent retailers



12. We shouldn't be beguiled by the large number of retailers now in the market:

- Nearly a quarter have less than 10 customers;
- Over half (22 out of 40) have less than 100 customers; and
- Three-quarters have less than 10,000 customers (29 out of 40 have less than 5,000).

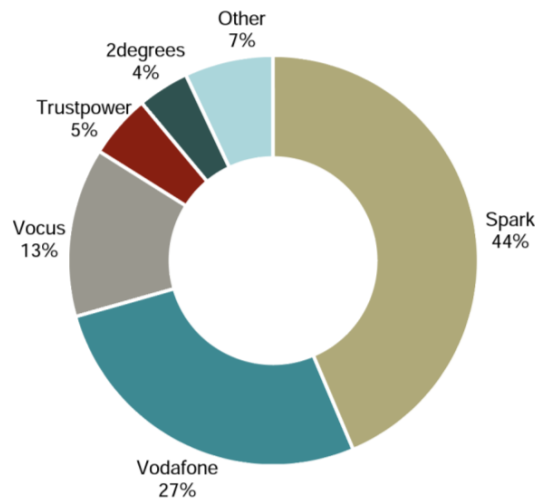
13. This compares poorly against the inroads entrant retailers have made in telecommunications.<sup>3</sup> A comparison of the rate of entrant retailer market penetration in telecommunications versus electricity is a good way of illustrating the challenges the Price Review faces in terms of delivering good outcomes and affordable electricity supply to consumers. Vocus, for example, now has 13% market share in broadband services, more than all entrant retailers in electricity combined.

<sup>2</sup>

[https://www.emi.ea.govt.nz/Retail/Reports/R\\_MST\\_C?DateFrom=20160901&DateTo=20180831&Percent=Y&seriesFilter=BCPL,TAOM,ECOS,ECOT,ELEN,ELKI,ENEL,EMHT,CLUB,ETRN,FLCK,HNET,IDPL,KEAE,KING,LITE,NEXG,S KOG,TODD,OPHL,ORSL,OURP,GIVE,PLEL,PION,PLUS,ORBS,PRME,CPPL,PUNZ,SIMP,STAK,SUPE,SWCH,WIS E,YESP&\\_si=v|3](https://www.emi.ea.govt.nz/Retail/Reports/R_MST_C?DateFrom=20160901&DateTo=20180831&Percent=Y&seriesFilter=BCPL,TAOM,ECOS,ECOT,ELEN,ELKI,ENEL,EMHT,CLUB,ETRN,FLCK,HNET,IDPL,KEAE,KING,LITE,NEXG,S KOG,TODD,OPHL,ORSL,OURP,GIVE,PLEL,PION,PLUS,ORBS,PRME,CPPL,PUNZ,SIMP,STAK,SUPE,SWCH,WIS E,YESP&_si=v|3)

<sup>3</sup> Commerce Commission, ANNUAL TELECOMMUNICATIONS MONITORING REPORT 2017 Key facts, 20 December 2017, figure 9.

*Estimated broadband retailer market share by connections*



**What would success look like for the Electricity Price Review?**

14. On the current trajectory, the five large incumbent electricity retailers will still have 80% market share in a decade's time. The oligopolistic nature of the electricity market remains stubbornly entrenched.
15. The current review can do better for New Zealand. Consumers should be able to expect to enjoy the benefits of a healthy-vibrant competitive market.
16. If the review is successful the five large incumbent retailers should lose their oligopoly status and there will be changes to who are the largest retailers. We would expect single digit market shares to be sufficient to be in the 'top 5' if the market is fully competitive. Only three retailers in the broadband market have more than 10% market share.
17. While this would be a good outcome for entrant retailers, it would, more importantly, result in more competitively priced electricity services that are affordable for most New Zealanders. Electricity prices could again be a source of competitive advantage for New Zealand businesses and exporters.
18. We don't think this is too much for New Zealanders to expect.
19. It will require changes some market participants won't like. This is nothing new. ECNZ objected to the creation of Contact Energy and its eventual full break-up. The electricity networks objected to vertical separation. Meridian opposed the physical asset swap in the last round of reforms.
20. The telecommunications industry provides useful precedent for the type of structural reforms that bring about genuine competition. Regulation evolved from financial separation of Telecom's wholesale and retail arms, then a corporate split and, eventually, full ownership separation. Chorus is now responsible for the wholesale business, and Spark (nee Telecom) has the legacy retail customer base. It was this final step to full separation of wholesale and retail which has delivered the biggest competitive benefits to the telecommunications sector.

21. These were all bold reforms that have delivered substantial benefits for consumers. Vocus recommends the Advisory Panel consider a structural split of the incumbent retailers' wholesale (including generation) and retail arms.

**Questions 15 & 16: The two-tier retail market and Saves and Win-backs are part of the same problem**

22. Vocus agrees with the Advisory Panel that “A two-tier retail market appears to be developing” where “those who actively shop around enjoy the benefits of competition, and those who don’t pay higher prices”.<sup>4</sup> Non-switching customers retained by the incumbent retailers are on inflated legacy price premiums.
23. Powershop, a wholly owned subsidiary of Meridian Energy (a large incumbent retailer), noted “existing retailers can and do [have different tiers of pricing for sticky and price-sensitive customers], because a negative pricing movement among the whole of a relevant segment of its customer base is significantly more expensive than just making [save offers] available to a few hundred customers”.<sup>5</sup>
24. Vocus also agrees with the Advisory Panel’s observation “The average gap between the cheapest retailer’s price and the incumbent retailer’s price has increased”.<sup>6</sup>
25. We had calculated, based on the Electricity Market Information (EMI) portal that the gap had increased, on average, by \$43.09, from \$164.38 to \$207.47 between 2016 and 2017 alone.<sup>7</sup> We now understand from subsequent Advisory Panel analysis that this substantially understates the gap as depicted in the following table.<sup>8</sup>

Table 1: Estimated average savings (\$/year) available to consumers from switching

Region	Savings based on 'X'th percentile			Electricity Authority estimate
	10 <sup>th</sup>	5 <sup>th</sup>	1 <sup>st</sup>	
New Zealand	240	280	400	
North Island	230	270	380	195
South Island	250	310	440	242

26. Behind those averaged figures there is a wide range of outcomes. Based on the EMI data, the largest increase was in North Canterbury at \$169.08, and there were several other areas where the increase was also in excess of \$100 or near \$100.<sup>9</sup> There were only three regions where the gap between the tiers decreased over this period. It would be useful to replicate these calculations with the more accurate data the Panel now has, and look into why there is so much variation in the price gaps between the tiers.

<sup>4</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 4.

<sup>5</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Powershop submission to Authority, Page 31.

<sup>6</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 4.

<sup>7</sup> [https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NZ&\\_si=v|3](https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NZ&_si=v|3) and [https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NZ&DateTo=20161231&\\_si=v|3](https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NZ&DateTo=20161231&_si=v|3)

<sup>8</sup> Electricity Price Review, Hikohiko Te Uira, Initial analysis of retail billing data 15 October 2018

<sup>9</sup> [https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NWK\\_REPORTING\\_REGION&\\_si=tg|residential-savings,v|3](https://www.emi.ea.govt.nz/Retail/Reports/W4TZQL?RegionType=NWK_REPORTING_REGION&_si=tg|residential-savings,v|3)



Residential savings league table (EMI data)

	2017 Measure	Change
Tauranga (Powerco)   1	\$444.43	\$44.93 ▲
Ashburton (Electricity Ashburton)   2	\$409.39	\$92.13 ▲
Nelson (Nelson Electricity)   3	\$400.36	\$103.81 ▲
Marlborough (Marlborough Lines)   4	\$355.62	\$124.79 ▲
Queenstown (Aurora Energy)   5	\$317.23	\$43.95 ▲
Waipa (Waipa Networks)   6	\$309.64	\$45.32 ▲
Otago (OtagoNet JV)   7	\$296.72	\$53.77 ▲
West Coast (Westpower)   8	\$296.12	\$47.83 ▲
North Canterbury (MainPower NZ)   9	\$295.52	\$169.08 ▲
Rotorua (Unison Networks)   10	\$271.51	\$52.26 ▲
Taupo (Unison Networks)   11	\$267.26	\$30.33 ▲
Southland (The Power Company)   12	\$263.72	\$84.55 ▲
Central Otago (Aurora Energy)   13	\$263.04	\$45.20 ▲
Whangarei and Kaipara (Northpower)   14	\$257.26	\$81.27 ▲
Tasman (Network Tasman)   15	\$244.04	\$119.51 ▲
South Canterbury (Alpine Energy)   16	\$236.07	\$81.04 ▲
Thames Valley (Powerco)   17	\$229.85	\$46.73 ▲
Eastern Bay of Plenty (Horizon Energy)   18	\$224.76	\$33.24 ▲
Eastland (Eastland Network)   19	\$221.40	\$47.16 ▲
Waitaki (Network Waitaki)   20	\$219.88	\$46.55 ▲
Bay of Islands (Top Energy)   21	\$219.19	\$94.34 ▲
Dunedin (Aurora Energy)   22	\$200.81	\$13.80 ▲
Central Canterbury (Orion New Zealand)   23	\$197.99	\$20.97 ▲
Invercargill (Electricity Invercargill)   24	\$195.23	\$42.85 ▲
Southern Hawke's Bay (Scanpower)   25	\$191.96	-\$35.05 ▼
Counties (Counties Power)   26	\$190.35	\$38.55 ▲
Buller (Buller Electricity)   27	\$188.45	\$20.30 ▲
Waitemata (Vector)   28	\$185.70	\$44.43 ▲
Wairarapa (Powerco)   29	\$185.37	\$17.81 ▲
Wanganui (Powerco)   30	\$182.72	\$35.37 ▲
Auckland (Vector)   31	\$182.50	\$44.97 ▲
Taranaki (Powerco)   32	\$175.43	\$51.49 ▲
Manawatu (Powerco)   33	\$150.03	\$13.93 ▲
Wellington (Wellington Electricity)   34	\$145.89	\$8.16 ▲
Waikato (WEL Networks)   35	\$137.56	\$40.68 ▲
Hawke's Bay (Unison Networks)   36	\$136.20	\$28.20 ▲
Central Hawke's Bay (Centralines)   37	\$135.25	-\$42.73 ▼
Kapiti and Horowhenua (Electra)   38	\$111.77	\$30.94 ▲
King Country (The Lines Company)   39	\$79.50	-\$46.46 ▼

emi.ea.govt.nz/r/uhbyt

27. Getting to the bottom of the two-tier market problem, including why the price gap between the tiers is getting worse, should be a key part of the next review steps.
28. The Advisory Panel noted the United Kingdom's Competition & Markets Authority and the Australian ACCC are also concerned about the emergence of a two-tier market and "*found that barriers included difficulties in comparing prices*".<sup>10</sup> The level of price transparency scores poorly compared to the telecommunications sector, where price is much more of a prominent feature of competitor advertising.
29. Issues with pricing transparency, and lack of consumer awareness of the savings they are missing out on, are undoubtedly part of the problem, but don't explain why the gaps between the two-tiers have grown, or why they have grown by such large amounts in the last year.
30. Vocus doubts it is a coincidence the incumbent retailers stepped up the level of their Saves and Win-backs retention activity over 2016-17 as this was when there were the largest increases in the price gaps between the two-tiers.<sup>11</sup>
31. The prevalence of win-backs isn't just a barrier to new entrants expanding,<sup>12</sup> it is one of the key enablers of the two-tier retail market. Win-backs enable incumbent retailers to discriminate between households that are able to seek out the best deals, and households unable to do so. Win-backs mean the incumbent retailers are able to make selective offers rather than offering lower prices for all consumers. Absent this ability, there wouldn't be a two-tier market.

### **Early notifications and near-term win-backs enable the large retailers to preserve and increase the gaps between the two-tiers in the retail market**

32. The Electricity Authority view was that restricting saves would "*increas[e] the incentive for retailers to **pre-emptively offer their existing customers a better deal***" [emphasis added].<sup>13</sup> The problem though is that near-term win-backs, within 3 months of the switch, are close substitute for saves. This is why the Electricity Authority initially proposed to ban near-term win-backs as well as saves,
33. Given there is nothing in the Electricity Industry Participation Code which prohibits win-back related withdrawals, prior to the first bill being sent a withdrawal post-switch is just as easy as a withdrawal pre-switch.
34. The original Electricity Authority consultation paper on saves and win-backs summarised the problem well: -

*"In most sectors, the incumbent supplier does not receive advance notice that a customer intends to change supplier. That information remains confidential to the customer and acquiring supplier until the switch is completed.*

*By contrast, in the retail electricity market, **the incumbent retailer is notified that a customer intends to switch before the process is completed**. The incumbent may use this information to seek to 'save' the customer.*

*The competitiveness of the retail market is driven in large part by acquisition activity*

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<sup>10</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 35.

<sup>11</sup> This can be observed from customer withdrawal statistics, available at:

[https://www.emi.ea.govt.nz/Retail/Reports/1D1AHX?\\_si=tg|consumer-switching.v3](https://www.emi.ea.govt.nz/Retail/Reports/1D1AHX?_si=tg|consumer-switching.v3)

<sup>12</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 42.

<sup>13</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.4

and the **threat of acquisition activity**. Saves make acquisition activity less rewarding, because a proportion of customers cancel their switch before it is complete. Further, saves have a **disproportionate effect on the profitability of acquisition activity, because they reduce benefits without reducing campaign costs**. The same issue arises in relation to early win-backs.

For small and new entrant retailers, **saves and early win-backs present a barrier to entry and expansion**. The effect on profitability is greater for such retailers as the costs of an acquisition campaign have to be spread across a smaller (or nonexistent) customer base.

*In some other sectors where retailers receive advance notice of impending customer switch decisions (such as New Zealand telephone landlines), saves are disallowed.”<sup>14</sup> [emphasis added]*

35. It is worth noting that in general the losing trader controls the timing for the completion of the switch as they must send the relevant completion file. This gives a losing trader enormous power to subvert the regulated period by simply completing switches faster, only to withdraw them immediately after a successful save. Unsurprisingly, this is exactly what has happened. In most markets, the losing retailer would not receive any notification that a customer had changed service provider.

#### **Question 25 (Part 1): What needs to be done to address the two-tier retail market problem**

36. The Advisory Panel will need to resolve win-backs if it wants to resolve the two-tier market problem. We consider the two-tier market problem to be the most significant competition issue which cannot be resolved through structural reform.
37. The Advisory Panel's intention not to examine the matter of win-backs in detail, because the Electricity Authority is investigating the matter, puts the success of the Pricing Review at risk. The Advisory Panel wouldn't be able to provide surety to the Minister that its recommended reforms would address the two-tier retail market problem, if the Electricity Authority hasn't resolve the matter before then.
38. The Electricity Authority does not have any specified end-date for the Saves and Win-backs review, and hasn't committed to continue the review beyond the consultation MDAG has already undertaken. Further, entrant retailers are on record expressing lack of confidence in the MDAG review process which, from the outside, appears to be dysfunctional. The MDAG review process appears to have been subverted by the three incumbent retailers on the group and we note the Chair of the Advisory Group resigned mid-process.
39. Vocus has recommended the Electricity Authority investigate incumbent retailer pricing behaviour, with a focus on determining the size of the spread in pricing between switchers and non-switchers, by each of the incumbent retailers. The end-goal of this investigation should be understanding the extent to which incumbents are keeping non-switching customers on high pricing and using this financial advantage to cross-subsidise retention activities on switchers.
40. This information would be equally useful to the Advisory Panel, to get a better handle on the size of the two-tier retail market problem. The Advisory Panel should be able to leverage off the Electricity Authority's information gathering powers if it can't obtain this information itself.

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<sup>14</sup> Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Executive Summary

41. Vocus considers electricity should take a lead from the restrictions in the telecommunications switching rules, which preclude saves and win-back. Vocus is of the view that in order for the two-tier retail market problem to be resolved, the following changes will be required:
- Amendment of the switching rules to reflect the Electricity Authority position “retailers **should not withdraw a completed switch unless the original switch request was an error.**”<sup>15</sup> [emphasis added]
  - Amendment of the switching rules to prohibit information obtained from the switching process from being used for any other purpose than facilitating the switch (consistent with the rules in telecommunications). For the avoidance of doubt, switching information should not be allowed to be shared with the incumbent retailers’ customer retention teams.
  - Amendment of the Saves Protection Scheme to exclude win-backs for the first 45 days after a switch (consistent with the Electricity Authority’s original proposals).

#### Questions 16 & 17: Market power problems and vertical-integration

42. When the Commerce Commission investigated the electricity sector it found “*each of the four largest gentailers - Contact, Genesis, Meridian and Mighty River Power - is likely to have held substantial market power on a recurring basis, particularly during dry years ... Each of these companies has the ability and incentive unilaterally to exercise market power and **increase wholesale prices during certain periods.** The price increases in dry periods are well above any increases in input costs, including the higher opportunity cost of water when hydro storage is low*” [emphasis added].<sup>16</sup>
43. The subsequent changes in market concentration levels have not been material enough to suggest the substantial market power the Commerce Commission found isn’t still an issue.
44. The ACCC’s competition law expertise, and information gathering powers, also places it in a strong position to assess issues with market power and vertical-integration in the electricity generation and retail markets.
45. The levels of market concentration and vertical-integration in the Australian and New Zealand electricity generation and retail markets are very similar. Most of the problems the ACCC identified in its electricity affordability report are directly applicable to the New Zealand situation.<sup>17</sup> For example:

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<sup>15</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 4.2.7 and 4.2.8

<sup>16</sup> Commerce Commission, media release, Commerce Commission finds that electricity companies have not breached the Commerce Act, 21 May 2009: <https://comcom.govt.nz/news-and-media/media-releases/archive/commerce-commission-finds-that-electricity-companies-have-not-breached-the-commerce-act>

<sup>17</sup> Electric Kiwi has made this point in the context of the two-tier retail market – Saves and Win-backs issue, pointing out that the problem definition in the entrant retailer submissions to the Electricity Authority mirror closely the conclusions reached by the ACCC: <https://www.ea.govt.nz/dmsdocument/23831-electric-kiwi-response-to-ea-saves-winbacks>

## WHAT THE ACCC HAD TO SAY

*Issues of market power: The ACCC found high and entrenched levels of concentration in the wholesale market have driven up prices: “the current wholesale market structure is not conducive to vigorous competition. In an energy-only bidding market, it is particularly important that there is sufficient competition between generators to deliver efficient prices”.*<sup>18</sup>

*Hedge market liquidity: “Some ... submissions acknowledged that liquidity and activity in these markets have decreased in recent years.”*<sup>20</sup>

*“ERM Power suggested that increasingly illiquid contract markets have likely contributed to increased retail prices, and that improving contract market liquidity will be crucial in reducing retail prices.”*<sup>21</sup>

*“By market share, the vast majority of NEM retailers manage risk primarily through vertical integration. The big three ... all own substantial generation assets ...”*<sup>25</sup>

## WHAT VOCUS HAS OBSERVED IN NZ

There is clear evidence generators, particularly Meridian, are using market power to raise spot prices.

The Electricity Authority identified some of the more extreme examples of this.<sup>19</sup> The behaviour can also be observed by comparing spot prices, and peaks in spot prices, between 2017, which was a dry-year, and the high prices that have occurred during 2018. This warrants investigation by the Advisory Panel.

We agree with the Advisory Panel “Some aspects of the contract market’s performance have faltered recently”<sup>22</sup> and “events during the winter of 2017 highlight the fragility of current arrangements”.<sup>23</sup>

It would be useful for the Advisory Panel to obtain an update from the Electricity Authority on bid-ask spreads. The Electricity Authority has provided this for 2017 but hasn’t provided an update for 2018.<sup>24</sup>

Meridian is using its market power in the wholesale market as a tool for managing its retail price risk.

This has been confirmed by the Electricity Authority’s investigation into Meridian’s spot market bidding practices.<sup>26</sup>

Meridian has also been upfront “Spot market volatility in the market is managed through vertical integration”.<sup>27</sup>

The gentailers also prefer to ‘balance their books’ by geographically matching their generation assets and retail customer bases rather than through hedging and contractual arrangements.<sup>28</sup>

<sup>18</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 88.

<sup>19</sup> Electricity Authority, Market performance review: High Prices on 2 June 2016, 18 December 2017.

<sup>20</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 107.

<sup>21</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 107.

<sup>22</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 44.

<sup>23</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 45.

<sup>24</sup> Electricity Authority, final report, 2017 Winter review, 22 March 2018, figures 14 and 15.

<sup>25</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 110.

<sup>26</sup> Electricity Authority, Market performance review: High Prices on 2 June 2016, 18 December 2017.

<sup>27</sup> Meridian, INTEGRATED REPORT FOR THE YEAR ENDED 30 JUNE 2017, It’s our future, page 29.

<sup>28</sup> The preference to use vertical-integration rather than hedging tools has been clear from the time ECNZ was split up. When Genesis, Mercury and Meridian were initially established as SOEs – some of the customer bases they ended up didn’t match their generation portfolios, and a period of customer rebalancing occurred. It happened again when the physical and virtual asset swaps were introduced which, again, resulted in mismatch between generation portfolios and retail customer bases.



## WHAT THE ACCC HAD TO SAY

Vertical integration: “As part of the Inquiry, the ACCC met with a wide range of small and medium sized retailers to discuss their experiences in the hedging market. A number of these retailers noted that they have trouble hedging. Hedging was identified as a significant differentiator between the relative competitiveness of retailers. Some stakeholders suggested that large, vertically integrated businesses are more able to hedge their wholesale risk effectively, and are able to do so at a lower price”.<sup>29</sup>

“The impact of vertical integration on contracting markets is complex but, generally, vertical integration results in an overall decrease in contract market activity by that business. The degree of vertical integration in the NEM may also be limiting the ability of standalone retailers to aggressively win customers as any significant expansion of retail market share will require securing wholesale supply from a competitor.”<sup>30</sup>

## WHAT VOCUS HAS OBSERVED IN NZ

The incumbent retailers have incentives and ability to favour their own in-house retail businesses, and to discriminate against stand-alone retailers, in the provision of hedge contracting arrangements.

These types of wholesale-generation vertical-integration issues haven’t received the level of attention that they have had in telecommunications, or in relation to electricity distribution vertical-integration.

It would be useful for the Advisory Panel to review of pricing of fixed-price variable-volume (FPFV) contracts against ASX future prices to help establish the extent to which vertically-integrated retailers are able to make offers below commercial market rates which would otherwise be available. This is information which the Electricity Authority can readily supply to the Panel.

46. We note Entrust has laid a complaint to the Commerce Commission regarding potential collusion between Meridian and Contact, Genesis and Mercury in respect of Tiwai Aluminium Smelter.<sup>31</sup> What this seems to represent is a variation on the classic monopoly problem of profit maximising by limiting supply. The incumbent generators are financially rewarded when market conditions are tight; particularly Meridian given its retail customer base is substantially smaller than its generation portfolio.
47. Vocus is also concerned the arrangements are at prices well below those available in the market, and that the result of the arrangements is a tightening of market conditions, resulting in greater market power problems and higher (less affordable) spot prices. A comparison of the Tiwai price (circa \$55) compared to the price retailers pay for hedging in the same region (circa \$70) suggests independent retailers pay more than the true wholesale cost.
48. It is also worth noting that one of the reasons Meridian was left so much larger (more market power) than Genesis and Mercury, when ECNZ was broken up, was the Tiwai Smelter contract. Now that Contact, Genesis, Mercury and Meridian have entered into joint arrangements for supply of Tiwai, this justification would seem to no longer hold.
49. While the matter of potential breach of Part 2 of the Commerce Act may be outside of the scope of the Advisory Panel review, impacts on wholesale market conditions and affordability are not.

Meridian neglected its northern most customers when it was first established, and then put a concerted effort into gaining North Island customers after the asset swap with Genesis. Genesis pre-empted the asset swap by making a decision to enter the South Island retail market in Dunedin and planned to expand into Queenstown and Christchurch – based on the premise of the asset swap taking place. The physical and virtual asset swaps were effective at providing the incumbent operators with access to electricity at fixed prices in regions where they had little or no generation capacity.

<sup>29</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 107.

<sup>30</sup> ACCC, Restoring electricity affordability and Australia’s competitive advantage, Retail Electricity Pricing Inquiry—Final Report, June 2018, page 128.

<sup>31</sup> <https://www.entrustnz.co.nz/news/media-releases/entrust-calls-on-commerce-commission-to-investigate-potential-restrictive-trade-practices-and-collusion-by-electricity-generators/>

## **Question 25 (Part 2): What needs to be done to address the market concentration and vertical-integration problems**

50. Vocus agrees with the Advisory Panel *“improving the depth and resilience of the contract market should be given high priority”*.<sup>32</sup>
51. While Vocus also agrees *“An effective contract market is critical to mitigating the potential adverse effects of vertical integration and short-term generator market power”*<sup>33</sup> the best solutions to structural problems are structural rather than behavioural regulation.
52. The only assured way the Advisory Panel can guarantee its Price Review recommendations will deal with the interrelated issues of market concentration, vertical-integration, and contract market liquidity is through structural reform. The ACCC, for example, recommended break-up of Queensland generation assets, and prohibition on acquisitions and other arrangements to limit market shares to 20%.
53. Absent any structural reforms, the Advisory Panel is limited to second best options aimed at curbing the ability of market participants with market power to mis-use that market power, including rules relating to bidding behaviour (alternative wholesale market designs include generators having to bid in at cost of production such as being operated by PJM in Pennsylvania) and market conduct, arm’s-length rules and financial separation of retail and generation, and hedge contract (market making) obligations.
54. Vocus recommends the Advisory Panel consider the following reform options:
  - a) Full vertical separation is the ‘gold standard’ for regulation of retail and wholesale (including generation) services.
  - b) If full vertical separation isn’t adopted, then corporate separation with arm’s length rules and financial disclosure requirements should be adopted.
  - c) Horizontal separation of generation assets – the ACCC recommended break-up of the Queensland Government’s generation assets, and prohibition on acquisitions and other arrangements to limit market shares to 20%.
  - d) Market making obligations *“whereby generators must offer to buy and sell a certain amount of electricity contracts each day”* (ACCC recommendation).

## **Question 30: Low Fixed Charge Regulations**

55. Vocus sees little or no merit in the Low Fixed Charge Regulations. The Regulations should be revoked. The Advisory Panel Retail Billing Analysis provides solid evidence the Low Fixed Charge Regulations should be revoked.
56. One of the anomalies of the regulatory settings for electricity and telecommunications is that a cap on residential fixed charges was introduced for electricity, but 100% fixed charges is required for residential telephony. In regions where water isn’t metered there has also been hostility to the introduction of volumetric charges despite the clear benefits of water conservation. It would seem unlikely fixed charges are bad in one network sector, but desirable others.

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<sup>32</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 45.

<sup>33</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 45.

57. It appears that because increases in fixed charges and residential electricity bills happened at the same time, the two were conflated in consumer minds. If part of the tariff rebalancing that resulted in higher prices for residential consumers is unwound, as the Advisory Panel proposes, this would compensate consumers who may be disadvantaged by removal of the Low Fixed Charge Regulations. The Figure 30 graphic in the First Report highlights many consumers on low fixed charge tariffs may actually be better off if the Regulations were revoked, regardless.
58. Vocus doesn't consider the Low Fixed Charge Regulations rate well on any criteria, be it efficiency, equity and fairness, or affordability.
59. The Low Fixed Charge Regulations impose additional compliance costs on electricity retailers, and can constrain or make it more difficult to introduce, new, more innovative tariffs. For example, where a retailer offers 'free electricity', it makes compliance with Regulation 9(2) difficult, and dependent on the retailer's assumptions about what amount of electricity is consumed during the "free" period. Electricity distributors have raised similar concerns, including that the low fixed charges are an impediment to reforms such as introduction of peak-usage pricing the Advisory Panel and Electricity Authority are both advocating.
60. Concerns were raised about how well the regulations would target those most in need when they were first introduced. Aged Concern was worried "*some of the most vulnerable older people are not actually low power users*" and "*spend a considerable amount of time at home and require a large amount of heating*".<sup>34</sup>
61. The Ministry of Consumer Affairs was similarly concerned about "*large consumers of electricity who are not rich, such as large families on low incomes, people with homes that are difficult (and costly) to heat, and low-income earners*". The latter group included "*beneficiaries who may spend more time at home, Maori and Pacific Island people*".<sup>35</sup>
- ... it is sometimes argued that high fixed charges are inequitable in that they favour rich consumers who use relatively large amounts of electricity. However, there are other large consumers of electricity who are not rich, such as large families on low incomes, people with homes that are difficult (and costly) to heat, and low income earners (e.g. beneficiaries who may spend more time at home, Maori and Pacific Island people).
- Under a variable charging regime (with low or no fixed charges), large consumers would pay a larger proportion of the fixed costs of the electricity network, in effect subsidising small consumers of electricity. Conversely, it is sometimes argued that low fixed charges favour pensioners and other disadvantaged groups. But, there is only weak evidence that these are low-rate users of energy and, in any event, not all consumers of small amounts are in this category. Examples of small consumers who may be favored if a high proportion of the electricity charge is variable include batch/holiday homeowners (who are likely to be on high incomes).
62. While the regulations technically exclude holiday homes, the reality is that it has not been practical to differentiate between holiday homes and people's main place of residence. From time to time we have discovered customers will sign up holiday homes with a different retailer to that of their main place of residence to avoid detection and benefit from low fixed charges on multiple properties. This is likely to be widespread but difficult to monitor given the lack of retailer visibility over properties held by other retailers.

### **The Low Fixed Charge Regulations are becoming increasingly outdated**

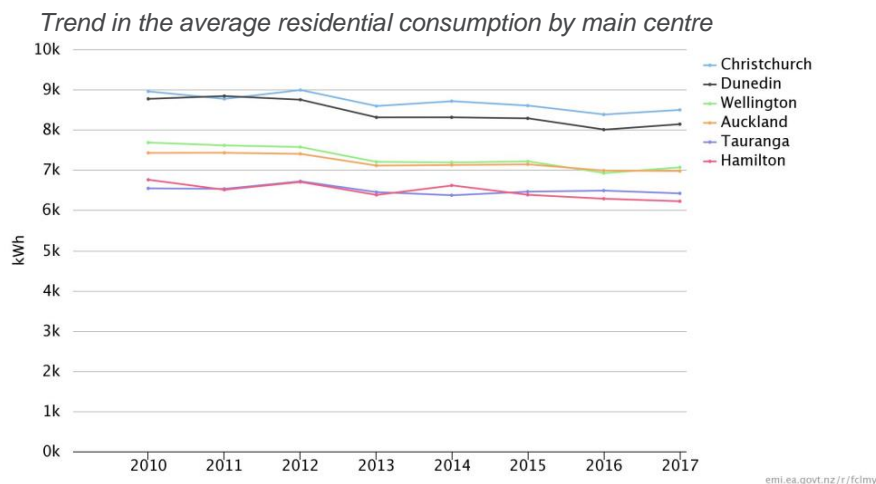
63. The issues with the Low Fixed Charge Regulations are getting worse.

<sup>34</sup> Power changes may not help the needy, by Jo McKenzie-Mclean, The Press, 19 July 2007.

<sup>35</sup> Submission to the Ministerial Inquiry into the Electricity Industry, March 2000.



- 64. The level of the fixed charge cap has declined in real terms. 30 cents in today's dollars is worth the equivalent of 23 cents when the Low Fixed Charge Regulations were introduced in 2004.<sup>36</sup> The fixed charge needed to increase to 40 cents to keep up with inflation.
- 65. Changes in residential consumer demand for electricity is also making the regulations outdated. The "average consumer" thresholds in the Low Fixed Charge Regulations have never been in sync with actual consumption, and the gap between the thresholds and actual demand is getting worse.
- 66. The gap between the "average consumer" threshold of 8,000 kWh, in areas outside the Lower South Region, and actual average consumption is getting wider and wider. Average residential consumption in Auckland is now below 7,000 kWh, and 6,222 in Hamilton.<sup>37</sup>



- 67. It was probably a mistake to introduce a higher, 9,000 kWh, threshold for the Lower South Region in 2009. If any change was made to the thresholds it should have been to introduce a lower threshold for warmer/lower demand areas, which was proposed at the time, but not a higher threshold for colder/higher demand regions.
- 68. Residential demand in the Lower South Region is tracking closer to the original 8,000kWh threshold than 9,000kWh. Average electricity consumption by residential consumers in Dunedin was 8,004kWh in 2016 and 8,140 kWh in 2017.<sup>38</sup>
- 69. The comparison between the "average consumer" in the Low Fixed Charge Regulations and actual residential consumption is even more stark when the comparison is made with median demand rather than average demand. The relativity between "average consumer" and median

<sup>36</sup> Electricity Price Review, Hikohiko Te Uira, First report for discussion, 30 August 2018, page 35.

<sup>37</sup>

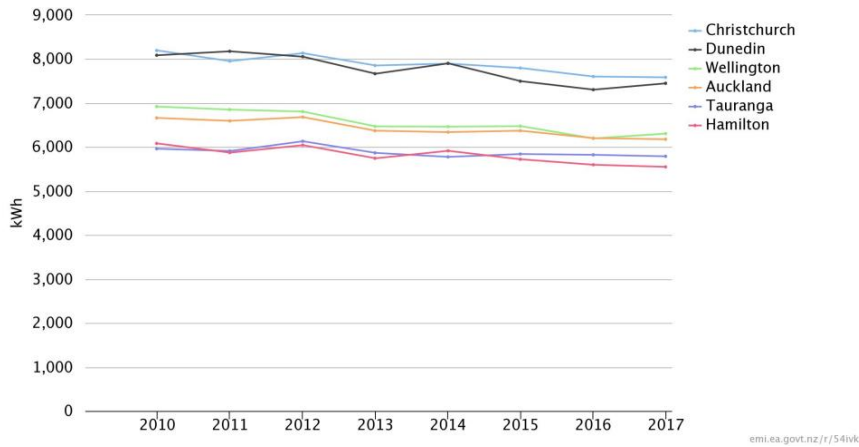
[https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN\\_CENTRE&Show=Avg&Timescale=Y&seriesFilter=&\\_si=tg|consumption,v|3](https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN_CENTRE&Show=Avg&Timescale=Y&seriesFilter=&_si=tg|consumption,v|3)

<sup>38</sup>

[https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN\\_CENTRE&Show=Avg&Timescale=Y&seriesFilter=&\\_si=tg|consumption,v|3](https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN_CENTRE&Show=Avg&Timescale=Y&seriesFilter=&_si=tg|consumption,v|3)

demand determines the numbers of consumers that benefit from being on the low fixed charge tariffs.<sup>39</sup>

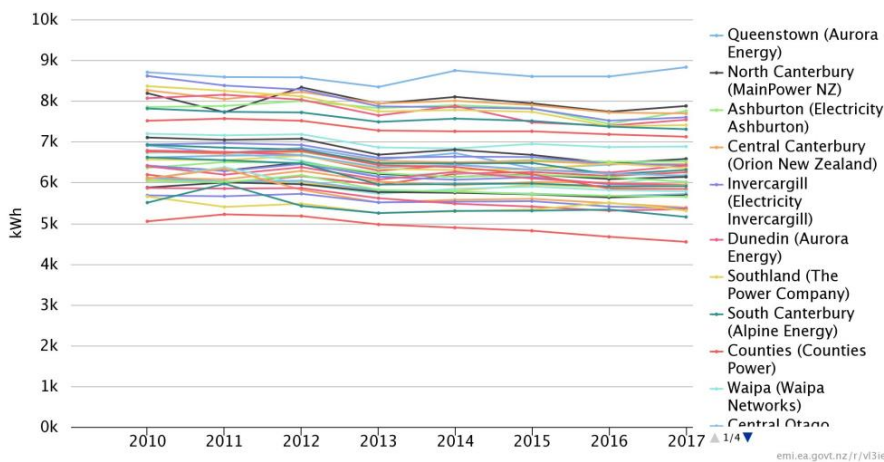
*Trend in the median residential consumption by main centre*



70. In 2010, there were only 6 network reporting regions, out of 39, where median demand was higher than 8,000 kWh, with none above 9,000 kWh.<sup>40</sup> These were limited to (from highest to lowest): Queenstown (Aurora), Invercargill (Electricity Invercargill), Southland (The Power Company), Central Canterbury (Orion), North Canterbury (Mainpower) and Dunedin (Aurora).

71. Now the only network reporting area with median consumption above 8,000 kWh is Queenstown (Aurora) at 8,830kWh.

*Trend in the median residential consumption by network reporting region*



39

[https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN\\_CENTRE&Show=P50&Timescale=Y&\\_si=tg%7Cconsumption,v%7C3](https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=MAIN_CENTRE&Show=P50&Timescale=Y&_si=tg%7Cconsumption,v%7C3)

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[https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=NWK\\_REPORTING\\_REGION&Show=P50&Timescale=Y&\\_si=tg|consumption,v|3](https://www.emi.ea.govt.nz/Retail/Reports/0YUCE0?DateFrom=20100101&DateTo=20171231&RegionType=NWK_REPORTING_REGION&Show=P50&Timescale=Y&_si=tg|consumption,v|3)

72. What this means is Queenstown is now the only area where consumers that should be on a low fixed charge tariff are in the minority (less than 50%). The “average consumer” threshold is now higher than the majority of residential consumers’ consumption levels in all other parts of the country.
73. Buller is completely out of kilter with the thresholds in the Low Fixed Charges Regulation with median demand of 4,452 kWh, and 75<sup>th</sup> quartile demand at 6,571kWh. There would only be between 5 and 25% of residential consumers in Buller (closer to 5 than 25%) that would be better off on the standard tariff.<sup>41</sup>
74. The effect of the Low Fixed Charge Regulations in Buller is little different to imposing a requirement all consumers be placed on the low fixed charge tariff. In this type of situation there are very few higher use consumers to subsidise the low fixed charge rate. This would likely have the effect of raising the variable charges for low-users, relative to arrangements where there is a more even split of low and standard-use consumers. Drawing on observation made by the Advisory Panel: “In theory, if a network only served [low-use] consumers, transfers would be entirely between those consumers”.<sup>42</sup> This example, in the extreme, is indicative of the distortions the Low Fixed Charge regulation produces across the market.
75. The issues the Advisory Panel has raised about current distribution pricing and solar are magnified by the low fixed charge tariff option. The Low Fixed Charge Regulations can result in bigger subsidies to consumers that can afford to invest in solar PV and batteries, and higher prices for consumers that can’t afford solar. This situation will get worse as solar PV and batteries become economic for households. We do not consider this to be efficient, or fair and equitable.

**Question 35: What needs to be done to address the Low Fixed Charge Regulations**

76. Vocus’ preference is for the Low Fixed Charge Regulations to be removed.
77. There may be merit in considering a transition phase to avoid price shocks during which the level of the low fixed charges are raised, and no new customers are entitled to the low fixed charge tariff option. The merit of a transition phase depends on a number of variables, including the impact of the next network price reset (reductions in interest rates could lower network charges) and if distribution businesses rebalance their tariffs in favour of residential consumers.

**List of recommendations**

78. We recommend the Advisory Panel consider the following reform options, including structural remedies where the underlying problems are structural:
- a) Amendment of the switching rules to reflect the Electricity Authority position “*retailers **should not withdraw a completed switch unless the original switch request was an error.***”<sup>43</sup> [emphasis added]
  - b) Amendment of the switching rules to prohibit information obtained from the switching process from being used for any other purpose than facilitating the switch (consistent with the rules in

<sup>41</sup>

[https://www.emi.ea.govt.nz/Retail/Download/DataReport/CSV/0YUCE0?DateFrom=20170101&DateTo=20171231&RegionType=NWK\\_REPORTING\\_REGION&Show=P50&Timescale=Y&\\_si=|consumption,v|4,\\_dr\\_DateFrom|20170101,\\_dr\\_DateTo|20171231,\\_dr\\_RegionType|NWK\\_REPORTING\\_REGION,\\_dr\\_Show|P50,\\_dr\\_Timescale|Y](https://www.emi.ea.govt.nz/Retail/Download/DataReport/CSV/0YUCE0?DateFrom=20170101&DateTo=20171231&RegionType=NWK_REPORTING_REGION&Show=P50&Timescale=Y&_si=|consumption,v|4,_dr_DateFrom|20170101,_dr_DateTo|20171231,_dr_RegionType|NWK_REPORTING_REGION,_dr_Show|P50,_dr_Timescale|Y)

<sup>42</sup> Electricity Price Review, Hikohiko Te Uira, Initial analysis of retail billing data 15 October 2018

<sup>43</sup> Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 4.2.7 and 4.2.8

telecommunications). For the avoidance of doubt, switching information should not be allowed to be shared with the incumbent retailers' customer retention teams.

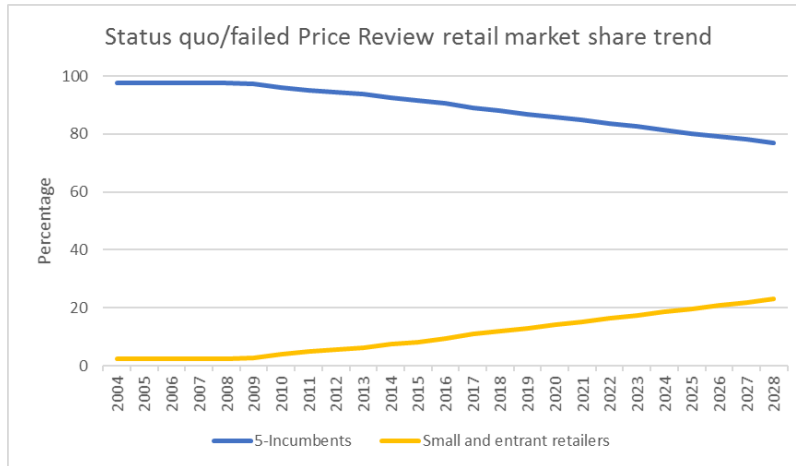
- c) Amendment of the Saves Protection Scheme to exclude win-backs for the first 45 days after a switch (consistent with the Electricity Authority's original proposals).
- d) New market and price monitoring provisions which *"includes the ability to observe retailer costs and gather information on the offers consumers are on, and what they are actually paying"* (ACCC recommendation).
- e) Full vertical separation is the 'gold standard' for regulation of retail and wholesale (including generation) services.
- f) If full vertical separation isn't adopted, then corporate separation with arm's length rules and financial disclosure requirements should be adopted.
- g) Horizontal separation of generation assets – the ACCC recommended break-up of the Queensland Government's generation assets, and prohibition on acquisitions and other arrangements to limit market shares to 20%.
- h) Market making obligations "whereby generators must offer to buy and sell a certain amount of electricity contracts each day" (ACCC recommendation).
- i) The Low Fixed Charge Regulations should be removed, with consideration given to phase to avoid price shocks.

### Concluding remarks

- 79. The competitive landscape in the electricity sector has improved following the last round of reforms.
- 80. Stakeholders wanting to defend the status quo tend to point to the number of retailers that have entered the market, and improvements in market concentration statistics.
- 81. The reality is that while there has been some improvement it has been very slow. There are a lot of retailers in the market, but the reality is that the market remains oligopolistic, and the gains in market share by entrant retailers remains low compared to other network industries.
- 82. What we would not like to see is need for another review in another nine- or ten-years' time, because the market is still oligopolistic and the five largest incumbent retailers market share has only decreased to 80%. This is where the sector is heading if the Price Review fails to improve competition.<sup>44</sup>

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<sup>44</sup> [https://www.emi.ea.govt.nz/Retail/Reports/R\\_MSS\\_C?\\_si=tglmarket-structure,v|3](https://www.emi.ea.govt.nz/Retail/Reports/R_MSS_C?_si=tglmarket-structure,v|3)



83. There is a lot more that could be done to make the electricity sector truly competitive, and to better ensure consumers are provided efficient and affordable services.
84. If the Advisory Panel review is successful it will be able to deliver substantial tangible benefits to consumers. The types of measures we will be looking at are whether the size of the gap between the two-tiers in the retail market halts its increases, and starts to decline, and whether there is an improvement in the rate of change in market concentration measures, such as HHI and the market share of the 3 largest (and 5 largest) retailers. We think it would be useful if the Advisory Panel set out projections of the outcomes from its proposals, in the next consultation. This will help make sure stakeholders can get an understanding of the benefits the Advisory Panel expects from its reform proposals.

Regards,

Johnathan Eele  
**General Manager Commercial and Regulatory**  
**Vocus Group**



22<sup>nd</sup> March 2019

## ABOUT VOCUS

1. Vocus New Zealand is the third largest fixed line telecommunications operator employing over 800 staff in New Zealand. Our retail operation includes a number of challenger brands - Slingshot, Orcon, Flip, CallPlus and 2Talk. We are also an active wholesaler of telecommunications services including access, voice and broadband over both fibre and copper.
2. Vocus has made significant investments in New Zealand. We are the largest copper unbundler with a presence in over 200 exchanges throughout New Zealand. In addition we operate 4,200km fibre optic network transits between virtually all major towns and cities, and connects directly into all major peering exchanges.
3. Our 200,000+ customers in New Zealand range from government agencies, integrators, large corporate, SME and residential households. We are committed to New Zealand's fibre future.
4. Vocus is committed to New Zealand and is one of the few large NZ telecommunications companies to base all its customer service call centres here in New Zealand rather than outsourcing its customer service operations overseas.
5. Vocus Group is one of the fastest growing telecommunications companies in Australasia and a major provider of voice, broadband, domestic and international connectivity and data centers throughout New Zealand and Australia.
6. Vocus Group bought New Zealand electricity retailer Switch Utilities in December 2015 and since May 2016 has retailed electricity under the Slingshot, Orcon, Vocus and Switch Utilities brands. During this time Vocus has acquired some 16,000 ICPs through various marketing channels and upselling to our telecommunications customer base.
7. Thank you for the opportunity to make this submission. If you would like any further information about the topics in this submission or have any queries about the submission, please contact:

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Vocus Group (NZ)

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22 March 2019

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## Submission on Electricity Price Review Options Paper

Dear Miriam,

1. Vocus welcomes the Electricity Price Review's preliminary Options Paper. We appreciated the opportunity to meet and discuss our views on 26 February, and at the subsequent 13 March workshop.
2. Vocus supports the predominant focus of the Options Paper on retail and wholesale market competition issues. This continues the focus on competition issues from the First Report. The issues we raised in our First Report submission predominantly related to how the conduct of the large incumbent retailers is detrimental to the development of competition and consumer interests. A large number of submissions followed a similar theme, including that of the other independent retailers, the ENA, and various of the ENA's members (and their Trust shareholders). We also acknowledge the Commerce Commission's concern about potential anti-competitive impact of win-backs.<sup>1</sup>
3. Leaving aside the views of the Electricity Authority and the incumbent retailers, the Panel should have confidence there is a high level of agreement around the competition problems in the electricity market, and the types of remedies which should be considered.

### Key questions to consider in finalising recommendations to the Minister

4. Vocus would like the Panel to consider the following matters while it deliberates on the final elements of the price review and the recommendations it will make to the Minister:
  - a) **What does successful reform of the electricity market look like?** How much further down the OECD rankings will New Zealand slip if the reforms aren't successful? On the basis of current trajectories, in 9 or 10 years time the 5 largest retailers will still have 80% market share. According to Electricity Authority data the level of retail-generation vertical-integration has hovered stubbornly in the mid-high 80% range, with no sign of letting up.
  - b) **What needs to be done to bring ahead the reforms more quickly, and faster than would be possible if legislative change is needed?** The Electricity Authority could implement most of the pro-competition reforms before the Panel finalised its recommendations to the Minister if they were minded to.

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<sup>1</sup> Various stakeholders like the Commerce Commission engaged on the two-tier retail market/saves and winbacks issue who had not engaged in the Electricity Authority/MDAG review.



- c) **Related to the above, what reforms will deliver the biggest ‘bang-for-buck’?** Vocus considers that a full ban (not a trial ban) on win-back, mandatory market-making and tougher wholesale disclosure rules are the most important reforms for promoting a healthy-competitive electricity market, followed by financial separation. A ban on win-back would not only reduce average retail prices, but it would also lower retail prices for lower income and vulnerable consumers.
- d) **Does it make sense for the Electricity Authority and Commerce Commission to adopt different interpretations of the objective to promote competition for the long-term benefit of consumers?** Under the Telecommunications Act, the Commerce Commission has made decisions, such as to promote competition by regulating Mobile Termination Rates, largely on the back of the benefits of wealth transfers (lower excessive returns) from incumbent suppliers to end-users. The Electricity Authority’s sole focus on efficiency means it ignores benefits to consumers from lower prices when it considers regulation. The creates a regulatory bias against reforms that would promote competition and improve consumer welfare (long-term benefit of consumers).
- e) **Should the Panel believe claims (Sapare etc) that win-backs are part of competition?** The Electricity Authority Advisory Group’s, MDAG, position that saves and winbacks isn’t a problem is out of step with not only the Panel, but also the ACCC and the UK Competition and Markets Authority (CMA).<sup>2</sup>

A simple test to determine whether win-backs are to the long-term benefit of consumers is to ask whether they result in higher or lower average residential prices. The UK CMA asked itself this question, looking at a broad range of industries, and concluded win-backs resulted in higher overall prices.<sup>3</sup> MDAG has ignored such matters in its consideration of win-backs which has meant it has ignored the main two-tier retail market problem a ban on win-backs would help address.

- f) **Should claims that mandatory market-claiming has high costs be taken seriously?** What about the costs of not intervening? The Electricity Authority’s UTS decision stated that “based on overseas experience” the costs “may be considerable”.<sup>4</sup> Experience in Singapore does not seem to bare this claim out, and the Authority and others haven’t corroborated the claims.
- g) **What should financial separation rules look like?** ERANZ and the incumbent retailers advocated the need for tight cost allocation and related party transaction rules during the Commerce Commission’s Input Methodologies review. These submissions and the Commerce Commission decisions should provide helpful precedent and guidance.
- h) **If structural reform of the retail-generation market is a step to far, should moderate enhancements to financial separation such as Operational Separation and arms-length rules be considered?** While Operational Separation is a second best option it is a less interventionist option which worked well in telecommunications prior to (voluntarily agreed) full separation.
- i) **Why have retail price caps been introduced in jurisdictions such as the UK?** Vocus doesn’t support this type of intervention. It would harm the prospect of retail competition developing the way it should. This kind of intervention can end up being introduced if

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<sup>2</sup> We were surprised the MDAG draft recommendations paper on saves and win-backs didn’t even make mention of the CMA report.

<sup>3</sup> <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

<sup>4</sup> Electricity Authority, The Authority’s decision on claim of an undesirable trading situation, 28 February 2019, paragraph 9.99.

competition policy fails and consumers lose confidence in the market. There will be a higher risk of this higher risk if the status quo is retained and reforms such as ban on win-backs and mandatory market-making aren't introduced. We consider that there already has been a drop in confidence in the market, as reflected in the 2018 UTS complaint.

## **Vocus considers that the wholesale and retail market reform proposals will result in better competition and lower prices for consumers**

5. Vocus generally supports the Expert Advisory Panel proposals to promote greater competition.<sup>5</sup> We would like to see the retail and wholesale reforms expedited in a timely manner. Our support is subject to the following qualifications and observations:
  - a) **Standard use-of-system agreements:** The experience with network access issues in electricity is quite distinct from telecommunications. We do not consider standardisation of network access arrangements should be treated as a priority.<sup>6</sup> In the 1990s retailers in the telecommunications market were vocal about a long list of access issues, but the same can't be said of the electricity industry.
  - b) **Mandatory market-making:** If the Panel favours the Singapore market-making model there is no reason it should take as long to develop and implement as it did in Singapore. New Zealand can leverage off the work done in Singapore.
  - c) **Trustpower-TECT arrangement in Tauranga:** Our experience with Part 2 Commerce Act cases in telecommunications is that they are slow and uncertain (data tails and 0867 being two examples). This would not be satisfactory for consumers in Tauranga. The establishment of the Telecommunications Commissioner and the Telecommunications Act 2001 had its origins in problems with reliance on the Commerce Act, and the CLEAR versus Telecom section 36 battles in the nineties. It is notable that MDAG has suggested Trustpower has market dominance in the Tauranga (and King Country) retail markets.
  - d) **Adding protection of consumer interests to the Electricity Authority's functions:** Vocus considers that a better way to ensure the Electricity Authority's decision-making is consumer-centric would be to clarify the Electricity Authority (under the Electricity Industry Act) and Commerce Commission (under Part 4 Commerce Act and the Telecommunications Act) are required to both interpret the statutory objective of promoting the "long-term benefit of consumers" to include benefits from efficiency gains and wealth transfers from suppliers to consumers.<sup>7</sup> This would mean the Electricity Authority would take into account both the benefits to consumers of efficiency gains (reduction in costs) and lower excessive profits. Consumers benefit from lower prices (or prices that are lower than otherwise) regardless of whether this is due to efficiency gains or wealth transfers.

## **Widespread support from First Report submissions**

6. The options the Panel has proposed to strengthen competition have broad support, based on the submissions on the First Report:
  - a) **Win-back ban:** There was a higher degree of engagement on the two-tier retail market (saves and win-backs) issue than there has been through the Electricity Authority (MDAG) review process. Additional independent retailers and various of the electricity networks (ENA,

<sup>5</sup> For the avoidance of doubt, this includes the proposal to explore options for bulk tender for social housing and Work and Income clients.

<sup>6</sup> There would be some efficiency gains if all the EDBs provided data in the same format.

<sup>7</sup> We raised this option at the 26 February meeting with the Panel.

Northpower, Top Energy and Vector), and the electricity trusts (Counties Power Consumer Trust, Entrust and Waitaki Consumers Trust), that hadn't previously submitted on the topic, all advocated for restrictions on win-backs.

The Commerce Commission also raised the potential that some retention activity could be anti-competitive: *"A competition concern could arise where the use of win-back discounts result in customer foreclosure and raising rivals' costs" and "discounts may be targeted at the high value customers, so that challenger retailers end up with disproportionately low value customers"*. While Consumer NZ argued *"Requir[ing] retailers to publish all available prices ... would avoid the need to regulate in regard to "win backs"'"* the Panel has ruled out this option.

At the 13 March workshop, Vocus noted that, notwithstanding the rules in telecommunications, the outcome is that win-backs don't happen due to third party install costs and CPE means that telecommunications RSPs assume once a customer is lost they are gone. This breeds behaviour of treating customers well, adding value and proactively managing prices meaning that we don't have a two-tier customer base of those who have been switchers and those who haven't.

Vocus notes there were suggestions at the workshop that pilots or regional trials of win-back bans could be conducted. Vocus does not support such an approach and considers that there should be full introduction to a win-back ban. We would support a Post-Implementation Review though.

- b) **Retail-generation financial separation and disclosure requirements:** Genesis proposed retail and generation financial disclosure requirements, including *"details of the transfer pricing by generator-retailers between their generation and retail segments, a baseload equivalent for Commercial & Industrial (C&I) Fixed Price Variable Volume (FPVV) products and disclosure of segment contributions from generation / wholesale operations"*.

We also note ERANZ and the incumbent retailers engaged substantively on the Commerce Commission's review of its cost allocation and financial separation rules in the Part 4 Input Methodologies. These submissions provide relevant precedent for retail-generation financial disclosure and cost allocation. In particular, we note concerns raised by the ERANZ and the incumbent retailers about application of the avoidable cost allocation methodology (ACAM) and optional variation accounting based allocation approach (OVABBA), and the preference for an accounting-based allocation approach (ABAA).<sup>8</sup>

- c) **Mandatory market-making:** While there were different views about how well the hedge market is working, there was support for reform. Meridian, reflecting its self-interest, advocated for minor change only suggesting that *"Strengthen[ing] the current voluntary ASX market-making arrangements by introducing greater incentives for market-makers"*.

We agree with Transpower *"Third parties should be able to negotiate for competitively priced hedges on equal terms to parties in common ownership (open access)"* and there is a need for *"providing much needed liquidity in derivative products through mandatory market-making obligations on the large gentailers ..."* We also agree with Vector that *"New Zealand stands*

<sup>8</sup> See, for example: Contact, Input Methodologies Review – updated draft decision on cost allocation, 13 October 2016 [misdated 12 August 2016], at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0023/60197/Contact-Energy-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0023/60197/Contact-Energy-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF)

ERANZ, SUBMISSION TO THE COMMERCE COMMISSION ON UPDATED DECISION ON COST ALLOCATION FOR ELECTRICITY DISTRIBUTION BUSINESSES, 13 OCTOBER 2016, at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0025/60199/ERANZ-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0025/60199/ERANZ-Submission-on-further-consultation-paper-on-cost-allocation-for-electricity-and-gas-businesses-13-October-2016.PDF)

*out among international electricity markets as having some of the lowest levels of contract market liquidity ... Liquidity indicators such as bid-offer spreads and contract churn rates are an order of magnitude below markets such as the UK, PJM and even Australia ...”*

- d) **Low Fixed Charge Regulations:** The Low Fixed Charge Regulations came in for near universal criticism with most submitters wanting the regulations to be abolished.

### **UK ‘Loyalty penalty’ super-complaint provides relevant new information to the two-tier market/saves and win-backs issue**

7. As we mentioned at the 26 February meeting with the Panel, the UK ‘loyalty penalty’ super-complaint is directly relevant to the affordability and competition issues the Panel is grappling with (and likewise the MDAG review of saves and win-backs).
8. Citizens Advice made a “*super-complaint*” to the UK Competition and Markets Authority (CMA) that not enough has been done to tackle loyalty penalty issues in 5 markets: mobile; broadband; cash savings; home insurance and mortgages.<sup>9</sup>
9. The CMA investigated concerns that people who stay with their provider can end up paying significantly more than new customers. The CMA findings were that:

“Overall, we have found that the loyalty penalty is significant and impacts many people, including those who can least afford it. Customers rightly feel ripped off, let down and frustrated. They should not have to be constantly ‘on guard’ or spend hours negotiating to get a good deal. This erodes people’s trust in markets and the system as a whole.”

“Some people wrongly believe that staying will pay off in the long term, do not know they could make significant savings or have other things to worry about, so do not even think about switching. It can also be confusing and time consuming to shop around, and suppliers can exacerbate these problems.”

“The loyalty penalty is of greatest concern when:

- It is particularly concerning when those that suffer are vulnerable, where they are unable to act to avoid the penalty, or they are not aware of it.
- it involves confusing or misleading customers, leading to poor decision making or undermines trust in markets;
- market characteristics suggest it is likely to increase average prices for consumers;
- it leads to harmful distributional effects;
- the product or service is considered ‘essential’ or constitutes a large proportion of people’s expenditure.”

“Robust estimates of the loyalty penalty in different markets are of clear value to regulators. It would help them to decide which markets they should investigate further and enable them to evaluate the impact of their interventions on the size of the loyalty penalty over time or for particular groups of consumers. In addition, we believe there is a strong case for regularly publishing estimates of the loyalty penalty. This can incentivise companies applying the loyalty penalty to change their behaviour, inform public debate and raise general awareness.

“Reputational incentives can be a powerful force in recognising and rewarding good conduct and discouraging exploitative behaviour or unsatisfactory performance. The potential impact on businesses’ brand value of reputational harm can focus minds at board level. Publishing business-level estimates of the loyalty penalty, and the associated media coverage and customer awareness, may prompt suppliers to offer better deals to longstanding customers and reduce the price differential in order to build a good reputation.

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<sup>9</sup> <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

"We therefore recommend that regulators should collect and publish indicative metrics on the existence and size of the loyalty penalty (ie price differences or number of longstanding customers) on a regular basis (such as annually, through for example a loyalty penalty report). ..."

10. It is notable CMA didn't recommend a single 'silver bullet' to address the loyalty payment issue. The recommendations included 'name and shame' (through disclosure of loyal penalties), as well as initiatives the Panel favours such as collective switching.

### **Structural solutions warrant consideration for structural problems**

11. We were disappointed that while the Options Paper did not favour full vertical separation, and instead proposed financial separation, there was no mention of moderate, intermediate, options such as operational (corporate) separation, non-discrimination requirements and arms-length rules. The Options Paper was also silent on horizontal separation of generation assets.
12. A number of submitters, e.g. Ecoctricity and Flick, as well as ourselves, commented favourably on the experience in telecommunications with the separation of Chorus (wholesale) and Spark (retail). Ecoctricity, for example, noted that *"As was seen in the telecom market some 7 years ago, when Telecom was split into Spark and Chorus, telecom costs to the consumer dropped significantly"*.
13. We acknowledge the Panel's qualification that some solutions the Panel doesn't favour *"may warrant reconsideration if the ones we do favour ... turn out not to deliver the expected improvements"* and *"separation will be unnecessary if the other four options are successful"* (emphasis added).
14. Vocus supports the intention that the *"... final report will recommend a high-level review three years after adoption of any recommendations the Government accepts"*. It will be important the Panel is clear about what the *"expected improvements"* would be from the reform proposals, to aid the ex-post review.

### **Vocus supports abolishing the Low Fixed Charge Regulations with a rapid transition**

15. Vocus' submission on the First Report highlighted how issues with the Low Fixed Charge Regulations are getting worse, with the value of the fixed charge cap declining in real terms (the cap would have needed to increase from 30 cents to 40 cents to keep up with inflation), and changes in residential consumption resulting in an increasing majority qualifying for the low fixed charge tariff.
16. We support the Panel's proposal to abolish the Low Fixed Charge Regulations. If a transition phase is needed it should be as short as possible.
17. Given removal of the Low Fixed Charge Regulations will generally help to address energy affordability; particularly for large low income households, if there is a transition it would be best for the Regulations to be phased out rapidly. We reiterate *"The merit of a transition phase depends on a number of variables, including the impact of the next network price reset (reductions in interest rates could lower network charges) and if distribution businesses rebalance their tariffs in favour of residential consumers"*.
18. The best and simplest way to phase out the regulations would be to make no changes other than to the fixed charge cap (say over two or three years) before removing the regulations completely.
19. While there are other options, such as making changes to the thresholds, so less consumers would qualify, these kinds of alternatives would be more suited to reform of the Low Fixed Charge



Regulations rather than their removal. It would be more disruptive if there were changes in who qualifies for the low fixed charge tariff at the same time as the regulations were being phased out. (If the Low Fixed Charge Regulations were to be retained, Vocus would advocate an increase in the low fixed charge, plus lowering the threshold to reflect a genuine medium, or preferably lowering the threshold so that, say, only 25% of residential consumers would qualify for the low fixed charge tariff.<sup>10</sup>)

## Risk of impediments to reform

20. An important consideration is how to implement the reforms as rapidly and expediently as possible. It is notable a lot of the recommendations, including win-back ban, mandatory market-making and tougher wholesale market disclosure and monitoring could all be implemented by the Electricity Authority without legislative change.
21. A concern we have is, if the Panel/Government wants to rely on the Electricity Authority to introduce reform initiatives within its legislation jurisdiction, what happens if the Authority, as an independent regulator, disagrees with the reforms?
22. This isn't a hypothetical question. The concern was raised by various submitters in relation to saves and win-backs. Since the Panel released its Option Paper, the Electricity Authority has come out and made opposing statements in relation to mandatory market-making.
23. While the Electricity Authority considers that hedge market liquidity could be improved, it has not made any commitment to initiating a review or on timing:<sup>11</sup>

We have a project in our indicative 2019/20 work programme with scope to look at this issue. ... We will make a final decision on our 2019/20 work programme in June 2019.

24. Further, even though the Electricity Authority hasn't decided to undertake a review yet, the Authority has commented that the "*voluntary market making arrangements ... has ... produced significant benefits*" and the review would "*consider a number of potential improvements*" but that "*based on overseas experience*" the costs of any intervention "*may be considerable*" [emphasis added].<sup>12</sup>
25. Similarly, by way of example, while the Panel proposes "*D1: Toughen rules on disclosing wholesale market information*" and that "*The Electricity Authority would vigorously enforce the existing disclosure rules ... and ... also identify any gaps in its power to require the disclosure of further information, such as contract fuel supplies*", the commentary in the Authority's UTS decision suggests that it considers it already has "*an effective information disclosure regime which is a fundamental feature of a well-functioning electricity market*".<sup>13</sup>

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<sup>10</sup> The Electricity Authority's EMI website includes this kind of information which could be used for revising the Low Fixed Charge Regulations. Our submission on the first report suggested that the last round of changes to the Low Fixed Charge Regulations were based on imperfect information about residential demand. For example: "It was probably a mistake to introduce a higher, 9,000 kWh, threshold for the Lower South Region in 2009. If any change was made to the thresholds it should have been to introduce a lower threshold for warmer/lower demand areas, which was proposed at the time, but not a higher threshold for colder/higher demand regions.

<sup>11</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, page apps 3.2 to 3.4.

<sup>12</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, paragraphs 9.98 and 9.99.

<sup>13</sup> Electricity Authority, The Authority's decision on claim of an undesirable trading situation: Claim submitted 8 November 2018 by Electric Kiwi, Flick Energy, Pulse Energy, Switch Utilities (Vocus), and Vector, Decision made: 14 February 2019, Decision paper released: 28 February 2019, paragraph 9.25 and and paragraph 9.23 onwards generally.

26. Saves and win-backs provides another example where it appears that there is a wide gap between the Panel and the Electricity Authority, at least based on MDAG commentary. While the Electricity Authority has recently floated the idea of a (limited?) regional trial, MDAG's draft recommendations paper concluded that there was no regulatory problem and a ban on win-backs wasn't justified. Notably, MDAG's "evaluation is not concerned with direct examination or diagnosis of problems relating to market performance – such as high average prices or distributional concerns"<sup>14</sup> and "Customer segmentation and non-uniform pricing ... are not market failures or regulatory problems and thus not considered directly in our evaluation".<sup>15</sup> Basically the MDAG position is that the two-tier retail market problems the Panel has identified is not a relevant consideration to the promotion of the long-term benefit of consumers.
27. If the Panel proposes to rely on the Electricity Authority it will be important to be clear about the specific nature of the proposed reforms ('the devil is in the detail'), so they aren't watered down or negatively changed, and all stakeholders are clear that legislative change will be introduced if the existing regulatory framework isn't otherwise sufficient to ensure the reforms are adopted.<sup>16</sup>

### Concluding remarks

28. There is a lot more that could be done to make the electricity sector truly competitive, and to better ensure consumers are provided efficient and affordable services. The Expert Advisory Panel proposals to promote competition are all reasonable and will unquestionably improve the level of competition in the electricity market. We welcome and appreciate the work the Panel has done, especially given the wide range of topics it was directed to cover.
29. We reiterate: "If the Advisory Panel review is successful it will be able to deliver substantial tangible benefits to consumers. The types of measures we will be looking at are whether the size of the gap between the two-tiers in the retail market halts its increases, and starts to decline, and whether there is an improvement in the rate of change in market concentration measures, such as HHI and the market share of the 3 largest (and 5 largest) retailers".
30. It could be useful for the Advisory Panel's report to the Minister to set out projections of the expected outcomes from its proposals. Consistent with this, the ACCC report on electricity affordability and pricing including projections of expected price reductions if its recommendations were adopted, which could be used to measure the success of the ACCC review.

Regards,

Johnathan Eele  
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**Vocus Group**

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<sup>14</sup> Market Development Advisory Group, Saves and Win-backs – Recommendations Paper, 26 February 2019, paragraph 2.6.13.

<sup>15</sup> Market Development Advisory Group, Saves and Win-backs – Recommendations Paper, 26 February 2019, paragraph 2.6.10.

<sup>16</sup> This could be done through a combination of section 18 review request by the Minister and Government Policy Statement.