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Energy Competition Taskforce
By email: TaskForce@ea.govt.nz

Dear Ms Kominik and Dr Small

Request for information on level playing-field measures (Initiative 1D)

1. The Energy Taskforce (the Taskforce) has sought preliminary input on the measures it could consider using to level the playing field between independent retailers (and, presumably, independent generators) and gentailers if earlier steps are not effective.

2. Vector ('we', 'our') has long been concerned about the disparities between independent operators and gentailers and the resulting adverse consequences for competition in the retail and wholesale markets. As we noted in our submission to the Ministry of Business, Innovation and Employment's (MBIE's) consultation on electricity transition measures:[1]

> *"A theoretically perfect market design can be undone (and potentially is already) by a market structure that is too concentrated.* ***Without a level playing field between large and small participants – for generators, retailers and consumers alike – intended benefits will not be realised****, and confidence will remain low. MDAG has been right to highlight that there are certain subcomponents of market supply in which concentration is likely to increase; interventions such as virtual disaggregation should be explored further, now. We have been concerned for some time that intervention is required to unlock the sufficient competitive pressure our market design relies on."* [Emphasis added]

3. Our previous submissions to the Electricity Authority's (Authority's) Market Development Advisory Group (MDAG)[2] and the 2018-19 Electricity Price Review panel (chaired by Miriam Dean CNZM KC)[3] expressed similar sentiments.

4. The Taskforce has not yet asked for substantive submissions, and so what follows is not comprehensive. We have instead endeavoured to provide a selection of heavier-handed 'regulatory backstops', with brief descriptions and highlighting some relevant precedent. We have not yet come to a firm view on which – if any – of these options we might ultimately support. We put them forward with the hope of helping to kindle a broader conversation.

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1 Vector, *Measures for transition to an expanded and highly renewable electricity system Submission to MBIE's consultation on electricity transition measures,* 2 November 2023, p.9 (available: here).

2 Vector, *Submission on the MDAG Options Paper – Price Discovery in a Renewables-Based Electricity System,* 20 March 2023 (available: here).

3 Vector's submission in response to the EPR's Options Paper (22 March 2019) can be found here.

5. As the Taskforce will be acutely aware, New Zealand's wholesale market is highly vertically integrated. New entry and investment – particularly from independent suppliers – therefore depend crucially on the performance of the contracts and derivatives market. Unfortunately, this market exhibits one of the lowest levels of wholesale liquidity in the world, relative to its size. In our opinion, this is a major problem that has long put a proverbial handbrake on new investment and independent retailing. It should consequently come as no surprise that many of the options introduced below are targeted at improving the depth and resilience of the contract market.

Vertical structural separation

6. The most decisive way to level the playing field between independent retailers (and generators) and gentailers would be to eliminate vertical integration altogether. Then *all* retailers and generators would be 'independent'. Vertical structural separation would be a dramatic step, but not unprecedented. Many electricity sectors (including New Zealand's) have unbundled the various elements of the supply chain into their constituent components – splitting off the monopoly services (lines) from the contestable activities (generation and retail).[4]

7. In some jurisdictions, generators were prohibited from having retail arms (and vice versa) following that unbundling. For example, when Texas's electricity sector was restructured in the early 2000s (the ERCOT[5] region), separation between generation and retail assets was mandated.[6] Although a single parent company was (and is) permitted to own both generation and retail assets, those operations themselves must remain completely structurally separate and run as independent businesses.

8. Vertical structural separation is also relatively commonplace in telecommunications sectors. For instance, in New Zealand, Australia and the United Kingdom, the formerly integrated providers of fixed-line telecommunications services (Telecom, Telstra and British Telecom, respectively) have all been structurally separated to varying degrees (after an initial period of operational separation – see below). This was ultimately seen as necessary to foster greater competition and innovation and to level the playing field in downstream markets.

9. Of course, compelling the divestiture of privately-owned assets (as opposed to government-owned infrastructure) is an extreme step to take in any market – and certainly not one to be taken lightly. In addition to the more modest intervention the Taskforce is actively considering in Initiatives 1A-1C there are various other, less intrusive backstops that could be attempted before this proverbial measure of last resort was seriously contemplated.

Vertical operational separation

10. One step removed from vertical structural separation is operational separation. This would involve creating at least two distinct business units within each gentailer, splitting out the wholesale and retail functions, which would then function as fully arm's-length operations. For example, although a (hypothetical) "Genesis Generation" and "Genesis Retail" would be part of the same economic entity, they would (in principle at least) act as though they were not. They would contract with one

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4 Admittedly, much of that was within the context of public ownership (or a transition to privatisation), and so there were fewer concerns about sovereign risk, impingement on private property rights and so on. But it does at least demonstrate that widespread structural change is possible.

5 ERCOT stands for the Electricity Reliability Council of Texas.

6 This requirement for structural separation was legislated in 2003.

another on an arm's-length basis as though they were independent, unrelated companies, and both should be incentivised to contract freely with other parties.[7]

11. As the Taskforce has indicated, it would then be necessary to introduce non-discrimination requirements to prevent the generation businesses from discriminating in favour of their own retail divisions (and vice versa).[8] The overarching principle should presumably be 'equivalence'. Namely, the default position should be that generation arms of vertically integrated companies should not offer more favourable prices to their affiliated retail business than to independent retailers – at least, not without strong justification. For example, the standard conditions of electricity generation licences in the UK (see: here) prohibit:

    a. Generators from selling electricity to any one purchaser (including, most notably, an affiliated retail business) at prices materially more or less favourable that those offered to comparable wholesale purchasers (accounting for volumes, load factors, conditions of interruptibility, dates and duration of agreements, etc.) (Condition 17).

    b. The cross-subsidisation of activities between the generation and supply arms of a vertically integrated entity. This means that profits or resources from generation cannot be used to support retail pricing or operational costs, ensuring independent retailers are not disadvantaged (Condition 17A).

12. However, equivalence extends beyond just price: it also encompasses availability. Equivalence of price (EOP) is meaningless if it can be circumvented by generators refusing to offer products (i.e., selling hedges to its own affiliated retail arm but not others). Hence, it would also be vital to ensure equivalence of *inputs* (EOI). The Taskforce could look to the telecommunications sector for guidance on this point (the Commission provides a comprehensive guide on equivalence and non-discrimination here). As a general proposition, the default position should be that all product offered to a generator's own retail division should ostensibly be available to all.[9]

Compelled/directed contracting

13. For completeness, we note that an even less intrusive option than operational separation would be to leave the gentailers' business structures untouched, but to require them to make a defined portion of their generation available to third parties via hedge markets. This would increase the number of contract market transactions and, in turn, the available price data. There are numerous examples of generators being required to offer a share of their generation – sometimes at a regulated price. For instance (this is a far from exhaustive list):

    a. In France, the vertically integrated utility EDF (Électricité de France) operates both generation and retail businesses and is required to sell up to 100TWh of its nuclear-generated electricity

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7 One important consequence of operational separation is that gentailers would no longer be able to maintain opaque natural hedges that obscure their internal transfer prices. Instead, gentailers' wholesale and retail divisions would need to enter into explicit contracts through the hedging market – the prices for which would be transparent to all parties under disclosure rules. It would not be necessary for the businesses to 'construct' a transfer price and report profits – that information would instead be available for all to see at the time contracts were agreed.

8 There would still be a financial incentive to discriminate in this manner, because the two branches would remain part of the same economic entity (absent full structural separation/divestment).

9 The application of non-discrimination/equivalence requirements, when coupled with the additional transparency stemming from the removal of natural hedges, would give independent retailers (and generators) greater confidence that the contract prices were reasonable. It would also facilitate more effective wholesale market enforcement.

to independent retailers at a regulated price in volumes determined by the French Energy Regulatory Commission, CRE (an overview can be found here).

b. In Ireland, a Directed Contracts regime was in place from 2012 to 2023.[10] Under this regime, large electricity generators were required by the regulatory authorities (the Commission for Regulation of Utilities) to offer a portion of their generation output to suppliers through a predefined set of contract arrangements at regulated prices (see a summary here).[11]

c. In the UK, Britain's major energy suppliers, (the 'Big Six'), have committed to trade a proportion of their generation output in the day-ahead market.[12] This is one aspect of regulatory measures introduced by Ofgem to address concerns about market dominance, to improve liquidity and to facilitate entry by smaller, independent retailers (see here).

d. In Singapore, from 2004 to 2019, large electricity generators were required to sell a portion of their generation capacity at a regulated price.[13] This volume, called the vesting contract level, was initially set at about 65–75% of total demand and was reduced over time as the market matured (and eventually phased out) (see here).[14]

14. At the risk of stating the obvious, irrespective of the option adopted, it would be important to ensure that a business could not comply with the applicable requirement by simply contracting a large part of that generation with itself. Plainly, that would undermine the chief purpose of any such measure, i.e., to assist independent retailers. The Taskforce's Initiative 1C is an important variant of this 'compelled contracting' option, i.e., compelling gentailers to offer a minimum volume of their flexible generation base to buyers in the form of risk management contracts.[15]

15. On the flip side, the Taskforce might consider also placing an analogous requirement on gentailers to procure a minimum quantity of generation (via contracts) from independent generators.[16] As we explain in more detail shortly, without a long-term power purchase (off-take) commitment an independent generator will invariably find it much harder than a gentailer to obtain financing for new investments. This represents one of the biggest barriers to new entry and expansion tilting the playing field against these suppliers.

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10 The Irish wholesale market evolved significantly since the introduction of Directed Contracts in 2012. As the share of renewable energy sources increased, there was a need for more flexible and competitive mechanisms to integrate these sources effectively into the grid. The transition to a new Capacity Remuneration Mechanism (CRM) was seen as a necessary step to support this evolution. The move also aligned with broader EU energy market regulations, which emphasise competition and integration of renewable energy sources. This transition was part of Ireland's commitment to meet EU targets for energy transition and decarbonisation.

11 The CRU typically considered several factors when determining the volume of Directed Contracts it would compel generators to offer, including market concentration (i.e., the larger a generators, the more of its generation might have been subjected to Directed Contracts), demand forecasts, capacity and availability, and market liquidity.

12 We understand that the exact proportion can vary between businesses and over time. The commitments are set out in their licenses issued by Ofgem.

13 Generators sold their obligated capacity to the Market Support Services Licensee (MSSL), which was primarily SP Services, a subsidiary of Singapore Power. SP Services acted as an intermediary, purchasing electricity at the regulated vesting contract price and then selling it on the wholesale electricity market.

14 A reasonably comprehensive overview of Singapore's vesting contract regime is provided in HoustonKemp's international review of market power mitigation measures in electricity markets. This report also covers case studies from Canada, the UK, Ireland, the EU and the USA. *See:* HoustonKemp, *International review of market power mitigation measures in electricity markets, A report for the Australian Competition and Consumer Commission,* May 2018, pp.31-32 (see: here).

15 Initiatives 1A and 1B also involve compelling gentailers to take certain actions in the hedging market.

16 There would presumably need to be contingencies put in place to deal with any scenarios in which there was insufficient generation available from independent suppliers to enable all the gentailers to comply with those requirements.

Retailer reliability obligation

16. In Australia, there is an explicit retailer reliability obligation (RRO) placed or retailers. The RRO compels retailers (most notably, gentailers) – and sometimes large energy users – to secure demonstrably (through contracting) enough electricity supply to meet their customers' needs during potential supply shortfalls. It commenced on 1 July 2019, with the aim of providing stronger incentives for market participants to invest in the right technologies in regions where it they are needed, to support reliability.[17] The RRO works broadly as follows:

    a. The RRO is only triggered if the Australian Energy Market Operator (AEMO) forecasts a significant gap between electricity demand and supply in a specific region over the coming five years. If AEMO identifies this reliability gap, the RRO becomes active, signalling that retailers must secure enough future contracts for electricity supply.

    b. Once triggered, retailers are required to contract a specified amount of capacity from generators or other sources to meet their forecasted peak demand for specific periods. This aims to ensure they have access to electricity even during extreme conditions, reducing the likelihood of load management (or, worse, blackouts).[18]

    c. Retailers must demonstrate compliance by proving they have sufficient contracts in place. If they fail to secure sufficient generation resources, they may face financial penalties, which can include the cost of emergency load-shedding or the high costs associated with scarcity in real-time markets.

17. The RRO is intended to act as a market-driven, market-like mechanism that simply incentivises more use of the contract mechanisms already available, and hence will serve to boost hedge market depth and liquidity. In turn, increased purchase of contracts by retailers will support increased investment by the *sellers* of contracts in dispatchable resources, like battery storage. This, ideally, then obviates the need for further government intervention to support investment. In other words, the RRO creates additional demand for power purchase agreements and other types of capacity contracts, since retailers know they must contractually secure electricity supply in advance of forecast shortfalls. This in turn potentially provides owners of dispatchable generation technologies with a steadier income stream – a win-win.

18. It may be worth investigating the feasibility of introducing something like the RRO in New Zealand. It may be more complex, or require a different focus – ours is a hydro-dominated system, where shortages often arise from meteorological conditions – but probably not impossibly so. A RRO might also be coupled with the previous option, i.e., an obligation on gentailers to procure a certain volume of dispatchable generation from independent suppliers.

19. This could be a useful way of spurring new investment and bolstering system reliability throughout the energy transition. On the flipside, if sufficient contracting is already occurring, the new constraints will be unlikely to bind retailers.

Horizontal separation

20. The options countenanced hitherto have all been variants of ‘vertical’ solutions, i.e., to address the potential incentive problems – and the uneven playing field – caused by vertical integration. But consideration could also be given to regulatory backstops involving *horizontal* separation. This could be achieved by creating a new state-owned enterprise (SOE) – a step suggested by

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17 Australian Energy Market Commission, *Final report, Review of the operation of the Retailer Reliability Obligation,* 29 February 2024 (available: here)

18 Retailers must demonstrate compliance by proving they have sufficient contracts in place. If they fail to secure sufficient generation resources, they may face financial penalties.

the Ministerial Review undertaken in 2009 (which led to creation of the Electricity Authority). Alternatively (or additionally), gentailers' generation assets could be reallocated amongst existing market participants to help boost competition. Asset reallocations are nothing new:

a. In 1999, Meridian exchanged some of its thermal generation assets with Genesis Energy to diversify its energy portfolio. This swap was aimed at balancing the generation mix of both companies, reducing the concentration of power and promoting competition.

b. Following the 2009 Ministerial Review (and upon the passage of the *Electricity Industry Act)*, ownership of the Tekapo A and B power stations transferred from Meridian Energy to Genesis Energy – again, this was intended to promote competition by balancing portfolios (see: here).

c. Also following the 2009 Ministerial Review, Meridian, Genesis and Mighty River Power (now Mercury) entered into a series of 'virtual asset swaps' involving financial hedges that effectively 'switched' southern and northern generation assets (see details: here).

21. We understand that the virtual asset swaps do not have long left to run. Presumably the parties could be compelled to extend them easily enough[19] if it was expected to level the playing field somewhat. Luke Blincoe, former CE of Electric Kiwi, has previously proposed a much more extensive form of horizontal separation. He has advocated for the creation of a new generation-only SOE made up of legacy hydro generation assets from Genesis's Tongariro, Mercury's Waikato River and Meridian's Waitaki hydro stations.[20]

22. The notion of creating a new SOE to provide a catalyst for competition in an historically cosy oligopoly is not merely theoretical. Kiwibank was founded in 2002 as a New Zealand state-owned bank for the express purpose of invigorating competition in the banking sector. The Commission's recently-concluded market study into personal banking highlighted the vital role that Kiwibank plays in New Zealand's banking ecosystem. A new generation-only SOE might similarly shake-up competition in the generation sector.

23. If reallocations were to be restricted to *existing* participants (rather than a new SOE), then the most obvious candidate for some other measure of horizontal separation or intervention would appear to be Meridian, and in particular the Waitaki assets. Indeed, there is a reason why it has been involved in every previous asset swap.[21] The MDAG explored the idea of potential forced sale[22] of Meridian's Waitaki hydro storage system as a way of reducing market power and improving market resilience. The group noted the following key points in relation to a potential sale:[23]

a. Meridian's control of the Waitaki system provides it with substantial flexibility in the supply of hydroelectric power and a considerable degree of influence over the market more generally.

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19 Of course, this would depend to a large extent upon the long-term fate of the Huntly plant, i.e., if/when it is likely to be decommissioned.

20 Blincoe., L, 'Time to break up Meridian' in *BusinessDesk,* 6 October 2020 (available: here).

21 From 2016-2018, Meridian was 'gross pivotal' in the South Island around 77% of the time. This increased to around 90% in the period between 2019 and 2021. *See:* Electricity Authority, *Market Monitoring Review of Structure, Conduct and Performance in the Wholesale Electricity Market since the Pohokura Outage in 2018*, *Information Paper,* 15 November 2021, p.42 (paper available: here)

22 A sale may be preferable to, say, a mere reallocation of assets (for no financial consideration), since this would leave both parties to the transaction as close to 'neutral' as possible from a market capitalisation/ shareholder value perspective. A non-sale reallocation would inevitably lead to much larger windfall gains and losses and attendant concerns about unjust enrichment or confiscation (as the case may be).

23 Market Development Advisory Group, *Price discovery in a renewables-based electricity system, Options Paper,* 2 December 2022, p.80 (available here).

b. A forced sale could theoretically improve market resilience by introducing an additional player that could manage the Waitaki system independently.

c. This diversification would spread decision-making authority across more companies, potentially enhancing the responsiveness of the market to supply-demand fluctuations.

24. The MDAG ultimately chose not to recommend physical disaggregation of the Waitaki system, since 'virtual disaggregation' (Initiative 1C) was thought to more effectively target the issue while avoiding the complexities of physical asset transfers. However, it should arguably be 'on the table' in the event that the lighter-handed options (including Initiatives 1A to 1C) do not produce the desired result.[24]

25. Alternatively, the Waitaki system – or parts of it, such as Lake Pukaki – might be operated as a 'virtual reservoir' (or 'storage warehouse') to facilitate hedging or more competitive access to key assets. Manawa Energy's (formerly Trustpower's) arrangement with irrigators concerning Lake Coleridge, established through agreements like those with the Central Plains Water (CPW) scheme and other groups, could serve as something of a blueprint. Under this system, irrigators book water in advance (up to 50 million m^3) and Manawa then coordinates the release from the lake into the Rakaia river where irrigators' infrastructure can capture it (see: here).[25] In a similar vein, Professor Grant Read recently proposed options for an expanded Lake Onslow to be used in this way.[26] In principle, there is no reason why a similar vertical disaggregation could not be made between 'upstream' reservoir management and 'downstream' generation (if, say, some of the Waitaki hydro stations were sold).

Underwriting new investment

26. From 2017-18, the ACCC undertook a wide-ranging review of Australia's electricity sector. One of its key findings was that independent generators – particularly new entrants – found it much more difficult than the incumbent gentailers to get new projects off the ground.[27] Where such projects were proposed by new entrants without a stable long-term downstream customer base, they tended to be unattractive for traditional financing. The ACCC found that financiers usually required the project developer to find customers who would commit to purchasing output from the project at a fixed price for an extended period.

27. The trouble was, although customers were often prepared to commit to shorter-term power purchase (of off-take) agreements (in the vicinity of five years) they were not willing to enter into longer-term arrangements (spanning ten years or more). To obtain financing on that basis, the developer would have no choice but to charge a much higher price per MWh in order to recoup its investment over the shorter period. Such prices were inevitably uncompetitive, scuppering the

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24 Much like vertical structural separation, any horizontal disaggregation that involved the forced divestment of privately owned assets would be a dramatic and controversial measure – and not one to be considered lightly. However, even if there was merely the *credible threat* of such a step being taken then that alone could play an important role in eliciting desirable behavioural changes from market participants.

25 This stored water provides reliability, supporting irrigation across thousands of hectares in Canterbury. Manawa charges a fee for the stored water, and any unused water does not carry over to the next season, encouraging irrigators to accurately forecast their needs for each season.

26 Professor Grant Read put forward this proposal in a report prepared for MBIE in the context of the Lake Onslow virtual battery project. *See:* Read., G, *Storage Options for the New Zealand Electricity Sector Operational and Organisational Issues, Prepared for the Ministry of Business, Innovation and Employment*, 14 July 2022, pp.54-55 (available: here).

27 ACCC, Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry, Final Report, June 2018, pp.98-100 (available: here).

project. Consequently, the playing field for new investment was tipped heavily against independent operators.

28. Vertical integration does not necessarily, in and of itself, solve this problem, as a retail base cannot necessarily be considered 'locked in' for more than a few years. Broad changes in the level of wholesale prices will flow through to retail prices, over time. But it clearly creates some advantage over independent power generation.

29. This problem was moderated by the Australian government establishing a temporary scheme to promote new investment by new entrants: the Underwriting New Generation Investments (UNGI) program. Under the UNGI initiative, the government would guarantee a certain level of revenue for qualifying projects through long-term contracts, which helped developers secure financing.[28] We expect that independent generators face similar hurdles getting new investments over the line in New Zealand. It may therefore be worth considering whether a scheme like the UNGI might also be an effective means of levelling the playing field here. It is also worth noting that:

    a. The government could easily use its streamlined, centralised procurement strategy (the existing 'all of government' tendering process, in which the government tenders for the supply of a large proportion of its load) to contract with and support independent generation, specifically; and

    b. As part of that process, it could specify that all generation procured via this process must be provided, for example, with renewable technologies commissioned post-2025.

30. Clearly another way to provide more financial certainty for new investments would be to remunerate generators not just for the electricity they produce but also for maintaining the capacity to produce power when needed – in other words, some form of capacity market could be introduced. However, mechanisms such as retailer obligations for enforced contracting should be explored and exhausted before any kind of centralised, whole-of-system procurement is contemplated.

Greater visibility of the coordinated management of consumer resources

31. We have observed with interest both gentailers and independent retailers expressing and demonstrating their aspirations to build portfolios of consumer-owned (or "behind-the-meter") resources, primarily to manage their spot market exposure. We note this is expressly supported by the Authority. [29]

32. However, we have an emerging concern with these arrangements, as well as other new demand-response contacts. On the surface, it seems unusual for parties to have the ability to control assets on both the demand and supply sides of the market, which could directly impact prices at the margin. How do we ensure these options and assets are used in ways that provide long-term

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28 In some cases, the government would also enter into contracts for difference to guarantee a minimum price for electricity generated by a project. It could also offer loans, grants or other forms of assistance. The government received 66 submissions in response to registrations of interest and, in March 2019, twelve projects were shortlisted for financial assistance. These included six renewable pumped hydro projects, five gas projects and one coal upgrade project. The shortlisted projects included every NEM region and represented a combined capacity of 3,818 MW of new generation (*See:* ACCC, Inquiry into the National Electricity Market, August 2019 Report, 20 August 2019, p.114 (see: here). The program closed on 25 October 2022. Details of the program can be found in the Regulatory Impact Statement (which can be found: here).

29 The Authority notes on page 3 of its November 2024 consultation paper, *Update to scarcity pricing settings,* that "*while controllable load is a useful tool for managing periods of tight supply, we want to see this controllable load shift from distributors to retailers and be signalled in the wholesale market.*" (available: here).

benefits to consumers? For example, what assurance do we have that the buyers of flexibility will exercise the options they hold at the optimal time for the system? Similarly, how do we know that integrated retailers (or any other retailer who is well-hedged) will actually drop their customers' hot-water and EV-charging loads in periods of high spot prices, if they themselves are net long in the market and actually benefitting from the high prices? How will the Authority make that assessment?

33. These questions highlight to us that there are currently no provisions in the Code to ensure unoffered resources are used in ways that are ultimately in the long-term interests of consumers. Their use is neither transparent nor monitored by the Authority, especially for those resources not separately metered. In a way, the Authority is building the house for mass participation of consumer resources before it has laid the foundations.

34. While we have not canvassed parallel rules in other jurisdictions, there are clear precedents in the Code governing operation of large power stations. However, the Code provisions in Part 13.5A, requiring all market offers to be made consistent with no participant being able to exercise significant market power (i.e. offers must not be made in a way that has a net adverse impact on economic efficiency), appear only to cover use of resources officially offered to the market. There are no parallel provisions for unoffered resources, or demand-response contracts.

35. There is no reason why the use of demand response (or virtual power plants) by market participants should not also be governed, revealed, monitored and reported in the same way as offered resources. The terms of material demand response agreements (and wider use of aggregated consumer resources) could be considered analogous to a form of generation that is activated to reduce net demand on the system. Any generation of this scale, if activated, would be required under Part 13 to be offered, and would therefore be subject to the offering rules in Part 13.5A. We also assume that, for portfolios of resources at these scales, requirements for information disclosure, and outage coordination, should also apply.

Mass switching trials

36. In 2019, the Electricity Price Review (EPR) concluded that a large share of the existing retail customer base is either unable or unwilling (for various reasons) to engage in the market. Independent retailers – including new entrants – may therefore be able to acquire significant volumes of lower-value price-sensitive customers quite quickly by offering cheap deals. But, crucially, attracting the disengaged customers of the incumbent gentailers is an altogether more daunting and painstaking process.

37. For that reason, the Panel recommended that the Authority conduct a pilot scheme whereby disengaged customers would be offered a 'bulk switching deal'. The Panel's Final Report makes it clear that the pilot was to be modelled on the scheme conducted in the UK – this precedent was explicitly referenced and the intent is unmistakable.[30] The idea was for the Authority to negotiate a bulk deal and then present that offer (with prices) to certain disengaged customers, thereby

[30] Electricity Price Review, *Hikohiko Te Uira, Final Report, 21 May, 2019*, p.39 (see: here).

enabling a mass migration – potentially to an independent retailer (assuming it offered the best deal[31]). This recommendation was accepted by the government.[32]

38. However, it is unclear whether this recommendation was ever implemented – at least not in the manner the Panel and the government intended. We understand the Authority partnered with Kantar Public in 2021 to conduct a pilot of some description. According to the Authority's response to the Minister's 2003 letter of expectations, the pilot was: *"mail-based, testing two behavioural-insight based variations of a consumer information letter. Both letters were designed to encourage the use of Powerswitch by consumers to check their electricity plan to find out whether they could be getting a better deal"*.[33]

39. The Authority published a pilot evaluation report in February 2022. Unfortunately, the link to this report was not working at the time of writing (see: here[34]). There is therefore no way to know what the letters said or, more generally, how closely this exercise mimicked the trial in the UK (that was intended to serve as a blueprint). For example, if those letters did not present a 'concrete' offer to customers (solicited via a similar means to those employed in the UK) and instead simply directed them to the Powerswitch website, then it would not have comported with the Panel and the government's express wishes.

40. Consequently, it may be that a core regulatory backstop proposed during the EPR remains unexplored and untapped. Regrettably, it is impossible to say for sure – but it does appear as though core attributes of the UK's mass switching trials could well have been absent from the 2021 exercise. If so, the Taskforce could consider revisiting this initiative which, as the Panel noted in 2019, showed considerable promise. Indeed, anything that would potentially enable independent retailers the chance to acquire scale in 'lumpier' increments could go some way to levelling the playing field.

Allow electricity distribution businesses back into retail and/or generation

41. When the electricity industry was restructured in the 1990s it made sense to prohibit distribution businesses from having retail and generation businesses. They would have had substantial advantages over potential competitors – particularly given their established customer bases. However, those concerns are not as valid today. For example, if distribution businesses were free to enter the retail and/or generation sector and some chose to do so, would or could they ever be more potent forces than the four major gentailers? Arguably not.

42. Meridian, Contact, Genesis and Mercury would remain by far away the most dominant presences in the wholesale and retail markets. They would have the largest retail customer bases,[35] the most diversified and established generation portfolios, strong balance sheets – the list goes on.

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31 Of course, in order for an independent retailer to take on significantly more retail customers it would need to have reliable access to reasonably priced hedging products – something which is impossible in today's wholesale market (which is amongst the 'least liquid' in the world, for one of its size). Consequently, the success of this 'mass switching trials' option would hinge greatly on the success of *other* options aimed at improving the conditions in contract markets. In this sense, the options presented in this submission do not always exist in watertight compartments. Rather, there is often significant overlap between them, with the viability of some resting on the successful implementation of others (and vice versa).

32 Ministry of Business, Innovation and Employment, *Cabinet Paper: Electricity Price Review: Government Response to Final Report,* 3 October 2019, paragraphs 88-89.

33 Electricity Authority, *Report on section 44B(2) matters*, 31 August 2023, p.14 (see: here).

34 On Monday 28 October the link was producing a "404 Not Found" error.

35 What is more, a significant proportion of those customer bases is known to be 'disengaged' or 'sticky' despite the best efforts of many parties – including the Electricity Authority and potential competitors – to entice greater levels of switching.

Such are the advantages enjoyed by the four largest gentailers that we suspect many distribution companies – perhaps most – would not even be interested in competing in these spaces. But some may, and maybe that could make a difference at the margin.

43. A larger competitive fringe can have a distinctly positive impact on competitive dynamics. That fringe can serve as an important counterbalance to dominant firms, fostering a more dynamic, consumer-friendly market environment through pricing pressure, innovation and increased choice. Innovative providers like Electric Kiwi, Powershop, Flick and Octopus have already had some success offering new, differentiated products, which have led gentailers to respond. The introduction of distribution businesses into the mix may spur even greater rivalry, innovation and investment.

44. Incumbent retailers and generators – including the independents – would be likely to express concerns about distributors engaging in various forms of conduct to unfairly advantage their own operations. If this option were seriously considered, then those concerns would of course need to be taken seriously (and potential mitigation mechanisms explored). Any potential costs would also have to be weighed against the potential benefits that a more effective competitive fringe of suppliers might provide in terms of levelling the playing field.

Concluding comments

45. We do not expect the options set out in this letter to represent an exhaustive account of the suite of regulatory backstops available to the Taskforce, but we hope they represent a useful contribution that can help kick-start discussions. To reiterate, the fact that a measure has been listed in this letter should not be construed as Vector supporting it. As stated earlier, that considered analysis is yet to be done and we look forward to working together with the Taskforce – and others – to arrive at a set of reforms that best promotes the long-term interests of New Zealand consumers.

46. We would welcome the opportunity to discuss these matters with you in more detail.

Yours sincerely,

James Tipping
GM Market Strategy/Regulation