

18 December 2017

Submission to Commerce Commission: Open letter on distribution sector work priorities and 2020 DPP reset focus areas

Entrust welcomes the Commerce Commission's proactive engagement with stakeholders on work priorities and preparation for the 2020 electricity DPP reset.

Concerns regarding price reductions being passed-through to consumers in full, including Entrust beneficiaries

Entrust considers that one of the Commerce Commission's priorities should be looking into the extent to which network price reductions, where they occur, are passed through into retail tariffs:

- the last two electricity DPP resets involved a mix of price increases and decreases,
- Vector has committed to reducing electricity network prices in both 2018 and 2019, and
- the most recent gas DPP reset reduced prices for all gas pipeline businesses.

Our expectation is that there should be 100%, and immediate, pass-through by retailers but we are far from confident this is happening in practice.

Entrust wants consumers, including the over 327,000 households and businesses in Auckland, Manukau, parts of Papakura and Franklin who are beneficiaries of Entrust, to all get the full benefit of the Commerce Commission's price regulation they are entitled to.

If retailers were willing to commit to full and verified pass-through for all resets resulting in network price reductions this would help give consumers confidence they aren't being taken advantage of. Entrust would like to see retailers behaving fairly and focus on doing the right thing by their customers.

Low interest rates heighten the importance of addressing the 'pass-through problem'

The issue of pass-through is particularly important in light of the impact interest rate reductions have had on the recent gas DPP reset.

The recent gas pipeline DPP reset resulted in gas network prices decreasing by around 13% or \$33 million a year compared with current prices. The Commerce Commission has "estimated that the pass through of this price reset would reduce average household consumer bills by approximately 6% in 2017/18".¹ This assumes 100% pass-through is occurring.

In the Auckland region alone, consumers should expect the \$54 million (or 21%) reduction in Vector's gas distribution prices over the next five years, in addition to a

¹ Commerce Commission, Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022, 31 May 2017.

share of the \$63 million (or 10%) reduction in First Gas' gas transmission prices over the same period, to be passed on through lower gas retail prices.

Entrust wants any network price reductions to end up in the right hands – beneficiary and consumer hands.

Weak retail competitive pressure

Every dollar of network price reduction retailers hold onto, is a dollar less in beneficiary and consumer pockets. This can only serve to undermine the achievement of the Part 4 objective to promote the long-term benefit of consumers.

There is no benefit to consumers from lowering lines company prices if this just fattens retailer profit margins. Failure by retailers to fully pass-through network price reductions can also result in efficiency problems (prices that are too high) and functionless rents.

Entrust doesn't believe the state of competition in the retail markets is currently strong enough to ensure retailers fully pass-through reductions in electricity and gas network prices. We are conscious there are issues with high market concentration, and vertical-integration of the big-five retailers, that could be hampering competition from working properly.

Fixed term contracts enable retailers to make windfall gains when network prices are reset

The growing prevalence of fixed term contracts can also slow down or delay retailers' pass-through of network price reductions.

More than 117,000 (34%) of Mercury's residential customers and 26,000 (63%) of its commercial customers are on fixed-term, fixed-price contracts.² These customers are vulnerable to delay in getting the benefits of network price reductions until at least after their retail contracts have expired.

Retailers with fixed term contracts could be receiving substantial windfall gains. The purpose of Part 4 of the Commerce Act is that price control is to the long-term benefit of consumers, not the benefit of retailers or their owners.

A network price pass-through study would be useful

Entrust welcomed the Commerce Commission's report on telecommunications wholesale pass-through. The report was commissioned "to understand how retailers of telecommunications services have passed through price changes in regulated wholesale copper prices to retail prices charged to residential consumers purchasing fixed-line services".³

We noted with concern pass-through as low as 80% of wholesale price reductions.

Entrust is uneasy there is no transparency about the extent retailers are passing through network price reductions in electricity and gas, and how quickly pass-through occurs. We

² Mercury, OUR 2017 ANNUAL REPORT, page 26.

³ <http://www.comcom.govt.nz/regulated-industries/telecommunications/monitoring-reports-and-studies/telco-wholesale-pass-through-study/>

note some retailers were hoping to receive Vector's electricity distribution price reductions earlier under the guise of helping the customer.

An investigation into the effectiveness of the pass-through would provide evidence as to whether this was bone fide or self-interest.

Entrust would like to see the Commerce Commission investigate pass-through of network price reductions to determine the extent to which consumers are actually benefiting from price regulation.

What we would like a network pass-through study to include

Questions Entrust would like to see answered include:

- What has been the level of pass-through since the current Part 4 was put in place?
- How long does it take for pass-through to occur?
- Do network price reductions get passed on to consumers by retailers as quickly as price increases?
- What is the size of windfall gains (excessive profits) to retailers from network price control resets when network prices are reduced and aren't fully passed on to consumers?
- Are there differences in the level of pass-through?
 - by different retailers (incumbent versus new entrant retailers),
 - within different regional markets across New Zealand, and/or
 - amongst different customer groups (residential, commercial and industrial)?
- What has been the impact of fixed-term contracts on pass-through?

Implications for any findings that there are problems with pass-through

A network pricing pass-through study could help identify issues with the way the Commerce Commission resets network prices.

It could also be useful for the Electricity Authority, GIC and the Government's Retail Price Inquiry. The study could identify the problem areas of the electricity sector the Retail Price Inquiry should focus its attention on. We have already seen retailers naked attempt to point the finger at electricity networks but the reality is that electricity networks are already rigorously price controlled by the Commerce Commission.

Inquiries in the UK and Australia have recently identified concerns about retail profit-margins and the true level of competition. Entrust considers that the study would help the Retail Price Inquiry establish the nature and extent of problems with retail competition which should be addressed. The rate of pass-through could be a useful measure of how competitive the energy retail markets truly are.

It may be beneficial to undertake any such study jointly with the other regulators, and the Retail Price Inquiry, or to liaise with them over the content and terms of reference for the study.

Closing remarks

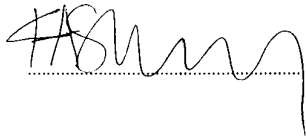
We are very uneasy about the lack of transparency over whether network price reductions are being passed-through, in full, to consumers; including the over 327,000 households and businesses who are beneficiaries of Entrust.

Getting an understanding of the extent of the 'pass-through problem' could determine whether changes need to be made to ensure full and immediate pass-through to the long-term benefit of consumers.

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Kind Regards



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