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Input methodologies review draft decisions

Topic paper 3: The future impact of emerging technologies in the energy sector

Mercury appreciates the opportunity to provide feedback to the Commerce Commission on its draft decision on the future of emerging technologies in the energy sector.

Mercury is an electricity generator and retailer providing energy services to homes, businesses and industrial customers throughout New Zealand. We have a long heritage in renewable energy in New Zealand serving about 1-in-5 homes and businesses under the Mercury brand and other specialty brands. We also have proven capability and technical expertise in smart metering services and solar. Our goal is to be the leading energy brand in New Zealand, inspiring our customers, owners and partners by delivering value, innovation and outstanding experiences.

We are excited by the opportunities new technologies will provide for our customers to enjoy electricity in new and different ways. We want to ensure all New Zealanders are able to access these new technologies at a price they can afford and with the features and services that they want. We consider the best way to ensure this is to enable as many providers of these services as possible to compete on price, service and quality. New technologies also evolve rapidly so it is important is that consumers are not locked-in to a particular model or features that may become obsolete quickly.

We think the Australian Energy Market Commission (AEMC) summed up this view well in it recent decision on how the costs of battery storage should be treated[1]:

> "Utilising the competitive market frameworks currently in place will allow consumer preferences to drive how the sector develops. New business models will be tested and those that offer value to consumers will thrive while those that do not will vanish. The way consumers value storage and associated services will determine the deployment of this technology and competition between providers will keep costs low. A consumer-led deployment is not necessarily orderly – but consumers are generally in the best position to decide what works for them. We are wary of proposals that seek to impose solutions or particular technologies on consumers at the expense of competition, especially where they result in consumers bearing the risks of the technology deployment."

We support the view put forward in the submission by the Electricity Retailers Association of New Zealand (ERANZ) that the Commission should reconsider its draft decision that batteries are regulated assets. We do not propose to re-state the arguments and evidence provided by ERANZ in support of its submission. However, we do support the legal advice that challenges the Commission's interpretation that batteries at the household level are within scope of regulation.

It appears the Commission remains unconvinced by retailers' views that a market-led approach to battery deployment at this stage is required or that sufficient evidence has been provided to prove that allowing a regulated approach now will prevent competition from emerging in the future. Further, the Commission views distributors as the main parties most likely to deploy battery storage and therefore are important to test the capabilities and initially establish the market.

[1] http://www.aemc.gov.au/Major-Pages/Technology-impacts/Documents/AEMC-Integration-of-energy-storage,-final-report.aspx pg ii

We appreciate the Commission has indicated it will play close attention to the situation and can intervene if it perceives issues for competition. However, in our view, and like the conclusion the AEMC have reached, it is preferable to set clear rules early on the market development rather than after significant investment has taken place. We are concerned that consumers will ultimately bear the risks of poor technology choices or deployment. Due to the fact that such assets will remain within the regulatory asset base, all consumers will effectively pay for the costs of potentially inappropriate investments.

Like distributors, retailers also potentially have an interest in investing in or having access to distributed storage. A retailer faces risk that it is exposed to the volatility of wholesale electricity prices, particularly where it retails on the basis of a fixed price but variable volume product which is prevalent in the industry. In electricity markets around the world there has been a trend toward vertical integration of retail and generation to manage these volatility risks by providing a natural hedge. Distributed storage is no different in effect to generation and therefore is equally attractive to a retailer in managing its risks as generation. Distributed storage may actually be more attractive, in effect, as being located close to load it will not be subject to network losses or price separation.

As the Commission notes, retailers also have a direct customer relationship and offering innovative products is an important aspect of demonstrating value to the consumer and maintaining that relationship. Given one electron is largely the same as another and electricity is a highly competitive market with very low barriers to switching, customer churn is high (in fact among the highest in the world in NZ) and is often the most significant cost for retailer.

If we compare two different investments, one regulated and one subject to competition, we can quickly see how regulation can quite feasibly stifle the market for battery storage at the household level in the longer term. A distributor's main objective will be to have a battery deployed as quickly as possible in areas of network congestion. Its main driver will be to ensure an equivalent service is provided to a traditional poles and wire investment (e.g. providing reliability).

Given it will earn a regulated return on that investment from all consumers in the network it should be largely indifferent about the consumer pricing for that product and only concerned that it is deployed (otherwise it will earn no return or meet its quality standards in which case it will be penalised). Given a distributor will not have access to endless capital and may perceive some risk with longer term and higher capital cost investments and it will earn the same rate of return regardless, it may well favour shorter term, lower capital cost investments like batteries, which have the further benefit of being mobile.

In comparison the returns to a retailer or other third party from an investment in a household battery product will be determined by what consumers are willing to pay in the marketplace. Where there is a regulated entity able to earn a guaranteed return and whose pricing is not subject to the market, the return required to the competitive player is likely to be much higher to compensate for this risk. In the long term this is why we believe this will lead to a reduction in competition for household battery storage and that this will limit choice for consumers and result in higher than necessary costs.

Please contact me on 09 580 3623 or nick.wilson@mightyriver.co.nz with any questions on the above.

Yours Sincerely,

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