20 June 2023

Consultation: ERP2
Climate Change Commission
P O Box 24448
Wellington 6142

Via web page portal

Dear team

Re: 2023 Draft advice to inform the strategic direction of the Government's second emissions reduction plan

Flick appreciates the opportunity to provide a submission on the Climate Change Commission's (Commission) draft advice to inform the strategic direction of the Government's second emissions reduction plan.

Flick agrees with the Commission's proposed recommendation

13. Prioritise and accelerate renewable electricity generation build and ensure electricity distribution networks can support growth and variability of demand and supply.

The Commission understands that prioritising and accelerating renewable generation build is critical to achieving emission reductions across not only the electricity sector but also transport and industrial processes. In our view other reforms are necessary in order for the electricity sector to deliver.

Flick is engaged in the process of design and implementation of initiatives by relevant energy sector government agencies to achieve a low emissions economy, in particular the Electricity Authority (Authority) and Ministry of Business Innovation and Employment (MBIE). Our focus is to ensure that the way NZ transitions to a low emissions economy results in sensible outcomes for electricity consumers (noting that more than 100,000 of NZ's households are currently experiencing energy poverty) and for the economy. That is, the balance is equitable between environmental responsibility and social responsibility.

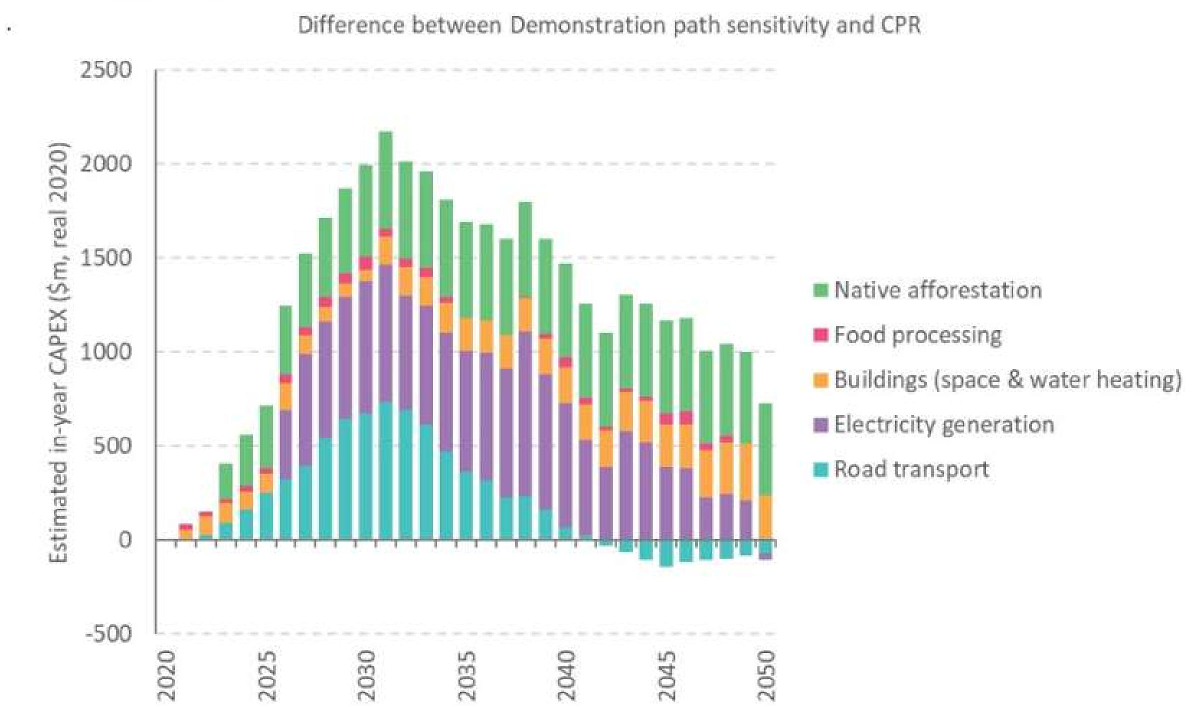
However, regulatory processes are slow and, as discussed below, our recommendations to the Commission in 2021 on its first draft advice are still highly relevant.

Workably competitive markets

Flick is concerned that "*A November 2022 report from the Ministry of Business, Innovation and Employment found that while work is underway enabling and investing in a low emissions economy, meeting emissions targets will depend on broadening,* *deepening, and accelerating current efforts in both the public and private financial sectors*"[1]. In our view, progress in constructing new renewable generation capacity is well behind that needed to meet growth in demand from sectors of the economy that have committed to reducing their reliance on fossil fuels.

The Commission has highlighted in its estimated yearly shortfall between expected capital investment under government policies (Current Policy Reference) and the Commission's demonstration path in the following graph.[2] This estimated shortfall may be understated.

Figure 14.1: Differences in annual capital investment between the modified demonstration path and Current Policy Reference case



The Commission recognises that "*Renewable electricity generation build needs to scale up quickly in order to reduce electricity generation emissions and support electrification of transport and heat. However, policy settings and other factors are creating investment uncertainty and delaying build*."[3]

[1] Page 161 of Draft advice
[2] Page 162 of Draft advice
[3] Page 109 of Draft advice

The Commission highlights consenting issues, as well as "*policy settings and other factors are creating investment uncertainty and delaying build*".[4] This is impacting the timing of Final Investment Decisions by incumbent and, more importantly, new entrant independent generators in the market for investment in new generation capacity.

In addition, the wholesale market for generation dispatch to instantaneously meet demand is being impacted by the increasing proportion of generation capacity that has no energy storage and relies on renewable fuel to arrive minute by minute. Given the current market structure and rules, wholesale market outcomes and retail market outcomes are negative for independent generators and retailers, and we believe for all New Zealanders. If independent competition in electricity retailing, and generation, is valued, changes are necessary to ensure a level playing field.

We suggest the Commission has a role in emphasising the need for urgency to address these issues. There are no regrets changes that can be made that can be expected to improve long term outcomes. Regulators should also be agile and adopt the regulatory regime over time if different outcomes arise.

Flick strongly believes that a much more competitive electricity market is needed <u>now</u> and for any successful energy transition to a renewables-based electricity system. Further, development and provision of risk management tools which enable independent operators to compete on a level playing field is an essential pre-requisite for a competitive market in generation investment and wholesale dispatch.

We reiterate our submission to the Commission's consultation on its first draft advice (March 2021). Nothing has changed!

> "Flick's view is that the incentives enabled by the vertically integrated structure of the dominant generators in the current market design is not delivering efficient outcomes for consumers. This is relevant to the Commission's work and modelling of future electricity prices, demand and impact on the economy. Current spot prices and hedge prices for the period to the end of 2024 are very significantly above the CCC's assumptions (for example $71.4-$78.3/MWh in 2024 compared with the ASX calendar 2024 price of $122.56/MWh on 12 March 2021).
>
> The government must be confident that the regulatory environment, and coordination of policies across government, will enable timely new infrastructure investment to support NZ's transition to low emissions. Under the current market structure – with a lack of competition in the generation market – we're not confident that sufficient investment will happen in a timely manner.

[4] Page 109 of Draft advice

The current barriers to competition and the existing market power are impeding the adoption of new technology and the success of new business models. NZ's regulatory settings have a critical bearing on how successful our transformation will be - including if new businesses and technology can be adopted on their merits. But settings need to change to enable this transformation. If successful, the electricity sectors' transformation will have an impact on the productivity and the competitive advantage of NZ (and consequently our national wellbeing) - conversely, if not, it will put these in jeopardy.

In our view, the dominance of the gentailers has to be addressed to ensure a highly competitive and well-functioning wholesale market delivering:

- strong competition to be the generator that is dispatched at the lowest economic cost - a cost reflective of underlying cost drivers and the long-run marginal cost of new generation
- strong competition amongst incumbent and independent generators to make timely decisions to invest in new generation capacity
- incentives on existing or new participants to solve the impact on security of electricity supply of low hydro storage.

In summary, it is critical that the right mechanisms, transparency and market structure are in place to ensure that electricity prices are affordable and supply is reliable as more people rely on electricity through the transition."

The price comparison provided in 2021 is now even worse: the Commission's demonstration path wholesale price of $100.9/MWh for 2024 and $96.8/MWh for 2025 compares with ASX prices on 16 June 2023 of $149.94/MWh and $161.41/MWh respectively at Otahuhu.

The Commission has recognised that "*Developers also control the timing of their generation investment … and will consider the broader impact across their portfolio before committing to build*".[5] Strong competition in the market for new generation investment should ensure timely and efficient investment is progressed.

We acknowledge that "*Private investment requires both policy clarity and investment confidence to redirect the flow of capital. The Government therefore has a key role to play in incentivising and de-risking private investment in the innovative and sustainable economic activities needed to meet its emission budgets and 2050 climate goals*"[6].

[5] Page 111 of Draft advice
[6] Page 163 of Draft advice

However, policy clarity / certainty does not deliver investor confidence if the 'certainty' relates to retaining a status quo that is not delivering a workably competitive market.

Flick recommends the Commission should advise the government that a study of the dominance of vertically integrated gentailers in both the generation investment and wholesale markets is in the best interests of consumers.

Dominance of vertically integrated players in the wholesale market also impacts outcomes in the electricity retail market - and therefore the prices paid by residential consumers. The Commission's forecast of the variable energy cost for residential consumers (declining by 1.1c/kWh between 2022 and 2025) is unrealistic given actual prices in the wholesale market and must be reviewed. With the OCR at 5.5% and additional investment required in networks to support increased capacity, distribution costs are likely to rise. Combined with our view of Internal Transfer Prices (calculated based on published methodologies) moving from circa 10.5c/kWh for the year to June 2022 to 14.4c/kWh for the year to June 2024, variable energy costs are more likely to rise by 4 - 6c/kWh between 2022 and 2025. In our view, more realistic forecasts of retail prices have implications for affordability and flow on decisions about whether to decarbonise and how to best support vulnerable consumers.

This study would report on whether the current market structure can be relied on to achieve the government's ambitious renewables and climate change targets in an equitable manner for the long-term benefit of consumers.

The Commission's recommendation to 'prioritise and accelerate renewable electricity generation build' is not sufficient to ensure NZ meets its legislated emission reduction targets.

Ensuring a workably competitive market in generation investment and wholesale dispatch is **urgent**. The Commission's demonstration path assumes new generation build completed by the end of 2025 that is capable of contributing an additional 2,200GWh of electricity (after completion of the Tauhara geothermal, Harapaki and Turitea wind farms which generate ~2,200GWh per annum). There is less than 18 months to the end of 2025. While there are generation projects in the construction process, our view is that new generation supply will fall well short of the Commission's demonstration path. The Commission has also, helpfully, detailed the cost of delay in terms of increased emissions.[7]

Does this shortfall in new generation capacity investment mean policy initiatives should slow down the rate of growth in new demand for renewable electricity or is the limited supply going to be rationed by being offered at higher prices? Both consequences will have a negative impact on emissions.

[7] Figure 9.2 page 112 of Draft advice

Demand side management

Flick has considerable experience in encouraging and incentivising demand side management by our customers.

Flick was set up in 2014 offering, for the first time, the opportunity for residential electricity consumers to purchase electricity at wholesale spot prices[8]. Customers had an App which told them the real-time wholesale price and received a warning if there were indications of high wholesale prices. This is a lived example of residential consumers being able to 'flex' their demand in direct response to the price they faced for electricity.

It is also a lived example of the direct negative impact of elevated spot prices and increased spot price volatility on customers. The change away from market fundamentals from late 2018 drove our decision to withdraw this product for new customers in February 2021. While some customers remain on this wholesale product, and are prepared to ride the volatility, we consider these people are 'much more sophisticated' electricity consumers.

In July 2021, Flick released an Off-peak product nationwide for residential consumers.[9] Flick also has a 'Best Plan Promise' and notifies customers every 90 days whether, based on their actual usage, they are better off on our Off-Peak or Flat plan. In this way we are encouraging consumers to think about when they use electricity. Flick has been, and continues to be at the forefront of innovation in this space.

Being an independent retailer means Flick does not own generation assets. We are reliant on purchasing electricity from businesses that own generation assets so that we have a 'product' to on-sell to our customers. Thus, as an independent retailer, Flick is commercially incentivised to:

- minimise the cost of buying electricity for on-sale to our customers
- use the hedge market (exchange-traded or OTC) to manage spot price volatility
- work with our customers to manage their and our exposure to high spot price periods.

The Authority's Market Development Advisory Group (MDAG) analysis for the 'Pricing in a renewables-based system' project has consulted on a number of proposals that should progress demand side participation. It is unclear when any of these proposals would be implemented.

We also agree with MDAG's observation that "*vertically integrated generator-retailers have dampened incentives to utilise DSF*"[10]. This is another reason we recommend the

[8] There was a direct pass-through of distribution charges plus a Flick fee.

[9] Initially it was not offered on one distribution network but is now available to all New Zealanders.

[10] Paragraph 4.55(b), page 36 https://www.ea.govt.nz/assets/dms-assets/31/MDAG-Library-of-options-FINAL-1.pdf

Commission should advise the government that a study of the dominance of vertically integrated gentailers is warranted.

We welcome the opportunity to discuss our information in this submission with you in more detail.

Yours

Pavan Vyas
Chief Executive Officer