Stakeholder briefing

Brent Layton (Chair)
Carl Hansen (Chief Executive)

7 February 2013

Board members

David Bull

Susan Paterson

Hon. Roger Sowry

Elena Trout

Our objectives and aspirations

CRE Aspirations

Widespread confidence in market competition	Widespread acceptance of efficient levels of reliability	Widespread recognition that markets are efficient

Statutory Objective

For the long term benefit of consumers

Promote competition	Promote reliable supply	Promote efficient operation

Our aspirations reflect consumer concerns

- Rational consumers want
    - Prices to reflect efficient costs, not everyone’s costs
    - Investment to occur when it is efficient and timely
    - Efficient levels of security and reliability

Key reliability initiatives are largely completed

- Tekapo A & B have been transferred to Genesis

- The Code has been amended to bring in
    - The customer compensation scheme
    - Stress testing and scarcity pricing

- The futures market is now providing transparent and robust forward signals of supply and demand risks for three years ahead

Hydro management was very good in 2012

- Will that performance be repeated in future years?

- The additional 5m of Lake Pukaki now available to Meridian when supply risks reach the 10% risk level changes the game again

Advice from the SRC on 28 May 2012

- Regulatory uncertainty is a significant security of supply risk
- Natural gas supply risks may not be well understood
- Market signals do not always provide the correct incentives to market participants in emergency situations
- Under-frequency management project actions need to be progressed

Advice from the SRC on 21 Sept 2012

- There is no requirement for summer security of supply standards

  "…there is no need for a summer energy margin and … summer capacity issues are well monitored under current arrangements and, accordingly, no summer capacity margin is required."

- Communication of reliability performance needs to be improved

  "…*the industry could improve communication to the different consumer groups … regarding the level of reliability that can reasonably be expected; and the industry's communication of information during loss of supply events … could be improved. The SRC did not identify there was a specific role for the Authority in relation to these matters."*

Competition initiatives are strategically important

- Competition in the wholesale and retail markets
  - Is essential to build credibility regarding retail price changes
  - Addresses concerns about asset revaluations
  - Is critical to building confidence in the hedge market
  - Provides incentives for innovation and operational efficiency
  - Provides incentives for timely and efficient investment, which is essential for achieving efficient levels of reliability

Demonstrable competition is key for regime durability

- Important to remember the electricity market
  - Is very young – it is a teenager really (< 20 years old)
  - It is yet to fully prove itself to the mainstream public
- Achieving demonstrable competition is critical for
  - Enhancing the political durability of the market approach
  - Facilitating regulatory certainty → timely investment → improves competition and reliability (creating virtuous cycle)

We've adopted several pro-competition initiatives

Market Initiatives	Primary Focus		
What's My Number campaign	C	R	E
Greater standardisation of distribution arrangements	C	R	E
Financial transmission rights (FTRs)	C	R	E
Demand-side bidding & forecasting	C	R	E
Retailer switching tool for SMEs	C	R	E
Futures market-making arrangements	C	R	E
Improving wholesale market information	C	R	E

But many more pro-competition initiatives to do

Market Initiatives	Primary Focus		
Dispatchable demand	C	R	E
Retailer default arrangements	C	R	E
Pivotal pricing arrangements	C	R	E
Nationwide ancillary markets	C	R	E
Intra-Island locational price risk hedges	C	R	E
Multiple frequency keeping (MFK)	C	R	E
Review of UTS provisions	C	R	E

But many more pro-competition initiatives to do, continued

Market Initiatives	Primary Focus		
Settlement & prudential arrangements	C	R	E
Review of half-hour switching process	C	R	E
Improving forecast & settlement prices	C	R	E
Under-frequency management technical review	C	R	E
Allocation of extended reserve obligations	C	R	E
Transmission pricing review	C	R	E

Market monitoring is also a key competition initiative

- Rigorous and transparent market monitoring is also a key facilitator of competition
  - We prepare reports into ad-hoc events, such as reserves pricing during winter 2012
  - We've released a set of competition metrics, for which we're assembling statistics
- We sometimes receive calls for the Authority to use sector profitability as a measure of competition
  - In our view that approach is dangerous and misleading

Stakeholder feedback on our work programme

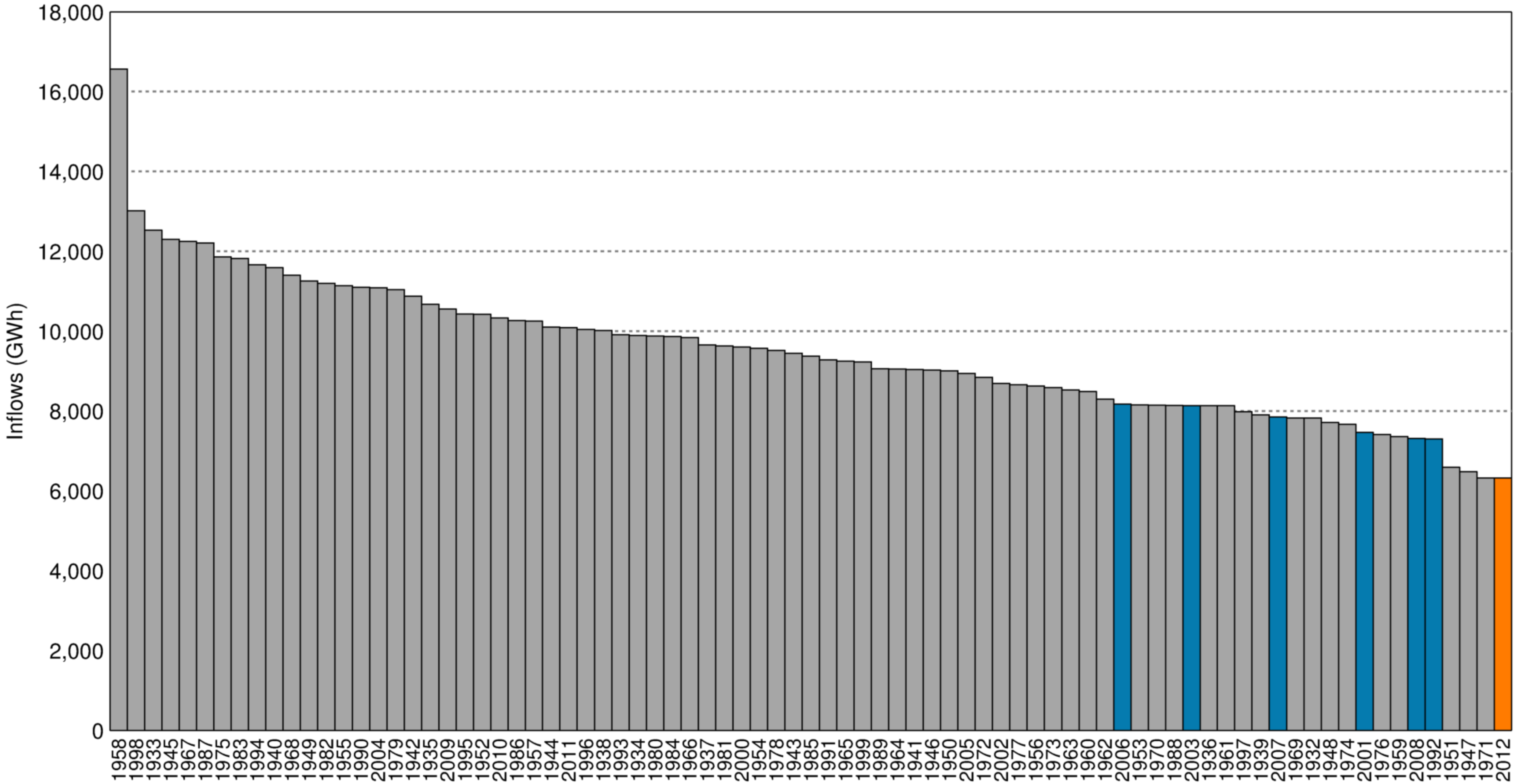
- Feedback on our proposed 2013-14 work programme revealed concerns about
  - Whether there were too many projects to properly manage
  - Whether many of the projects would deliver sufficient net benefits to consumers to be worth undertaking
  - Whether current initiatives needed to 'bed in' before determining whether more initiatives were needed
- We're committed to pursuing all pro-competition initiatives quickly
  - But will look to scale-back/defer other work programme items

A strategic directions document will be released shortly

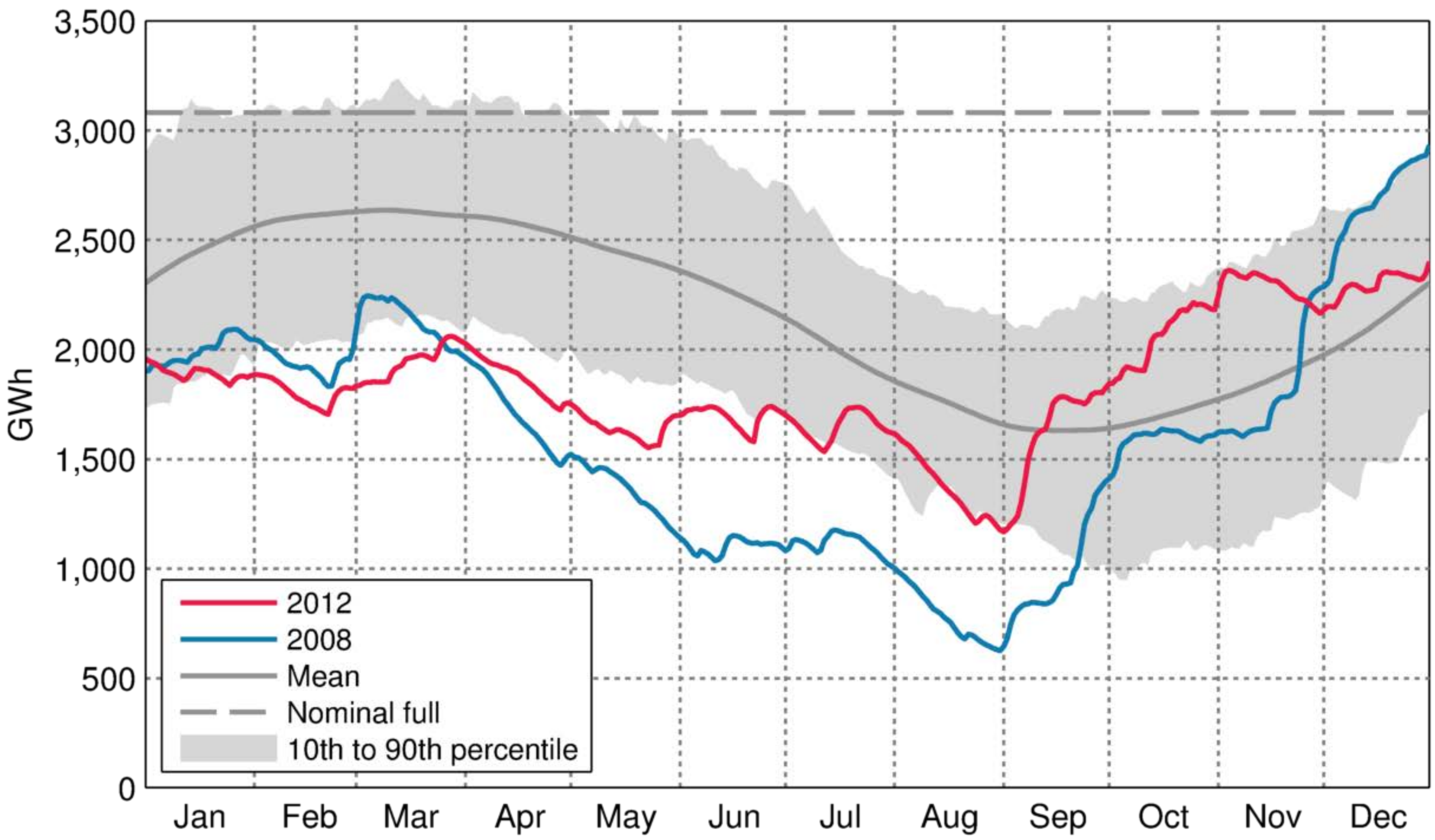
- The document
  - Reviews key challenges over next 10 years, covering technology and consumer trends
  - Sets broad directions for market development over next 10 years, which build on our emphasis on promoting competition
  - Outlines more fully the Authority's approach to regulation
- We will be seeking stakeholder feedback before finalising the document

Key market developments in 2012

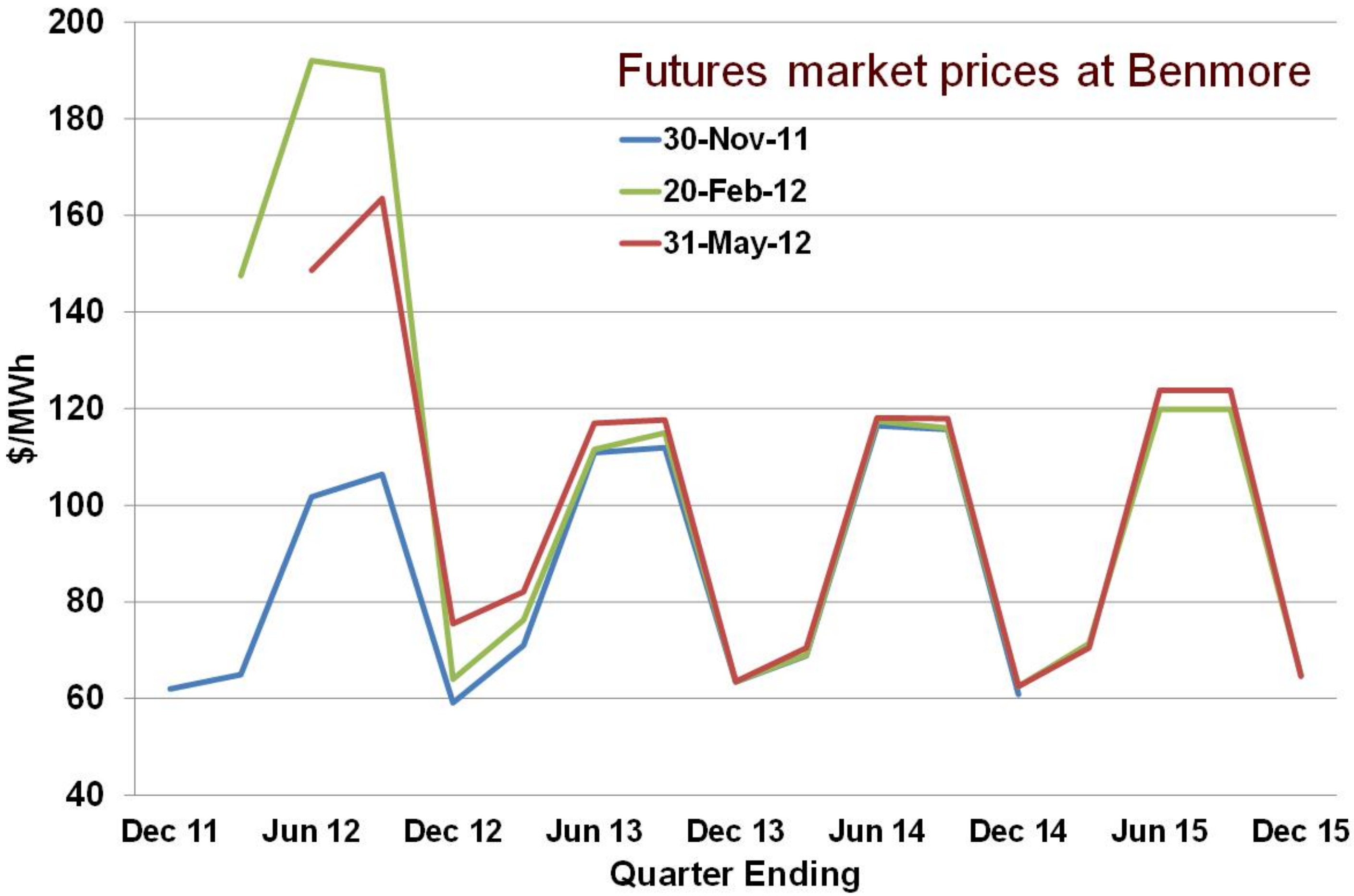
First 6 months of 2012 gave record low SI hydro inflows



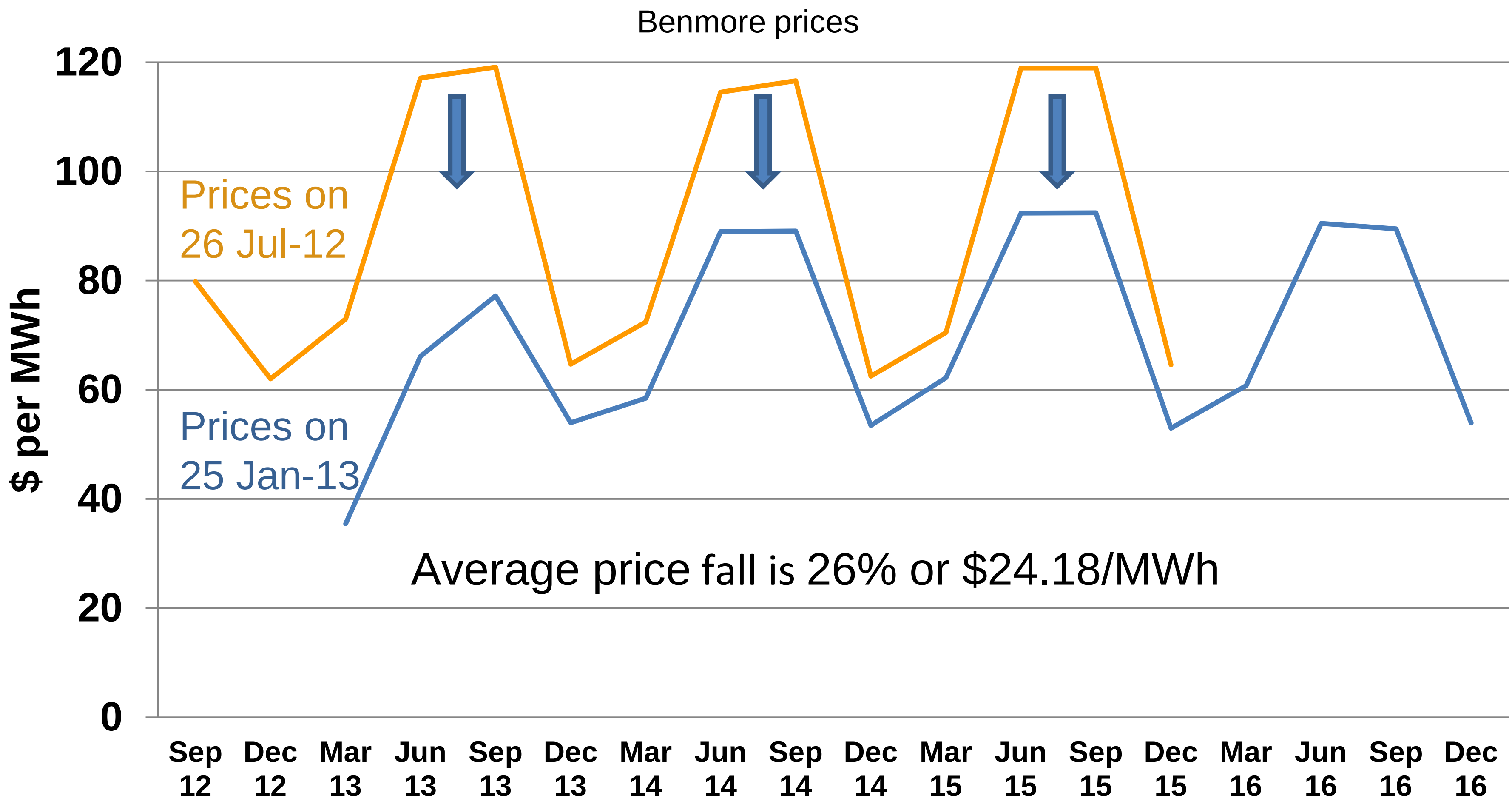
But SI storage stayed at higher levels than in 2008



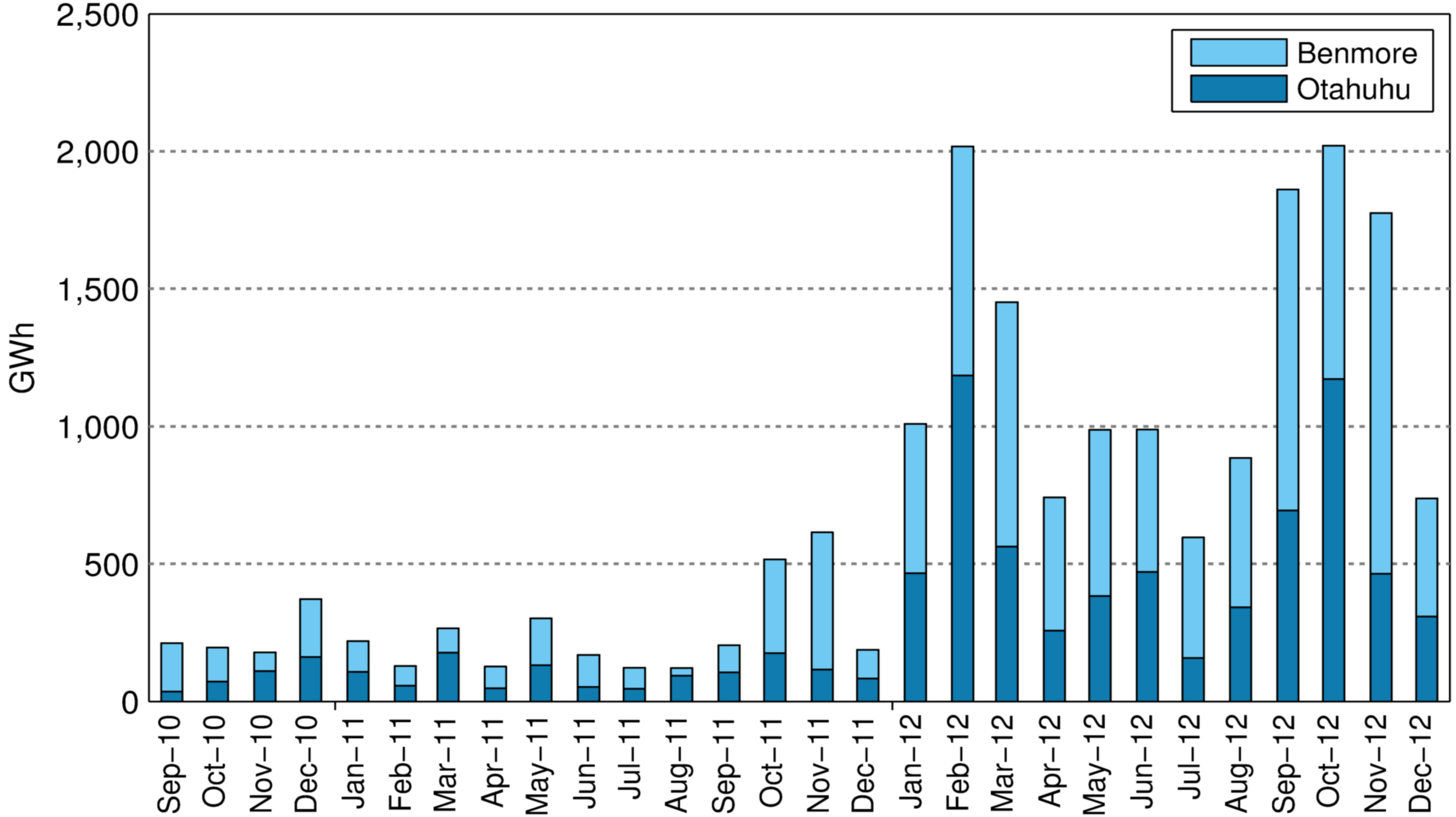
Hydro situation driving near term futures prices but long-dated futures pretty steady



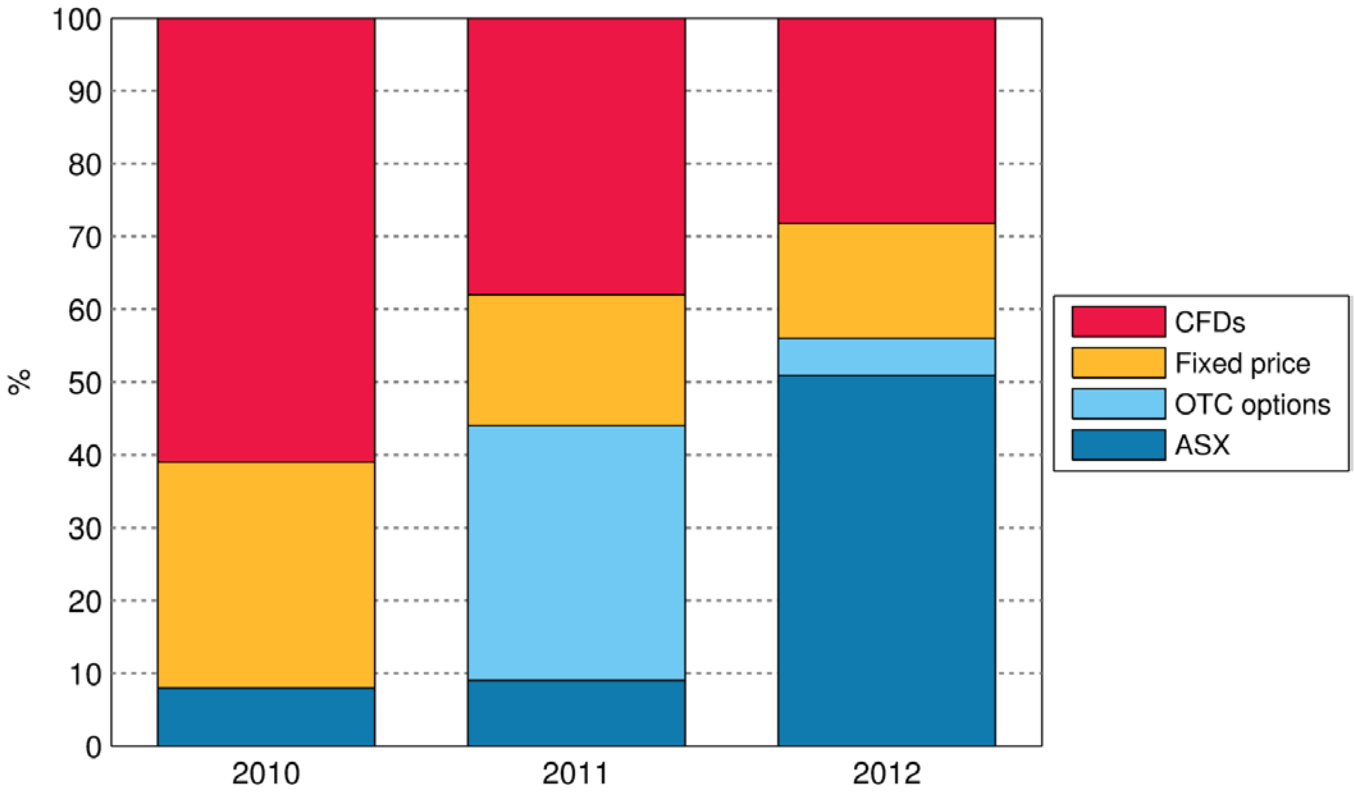
Large falls in futures prices over last six months



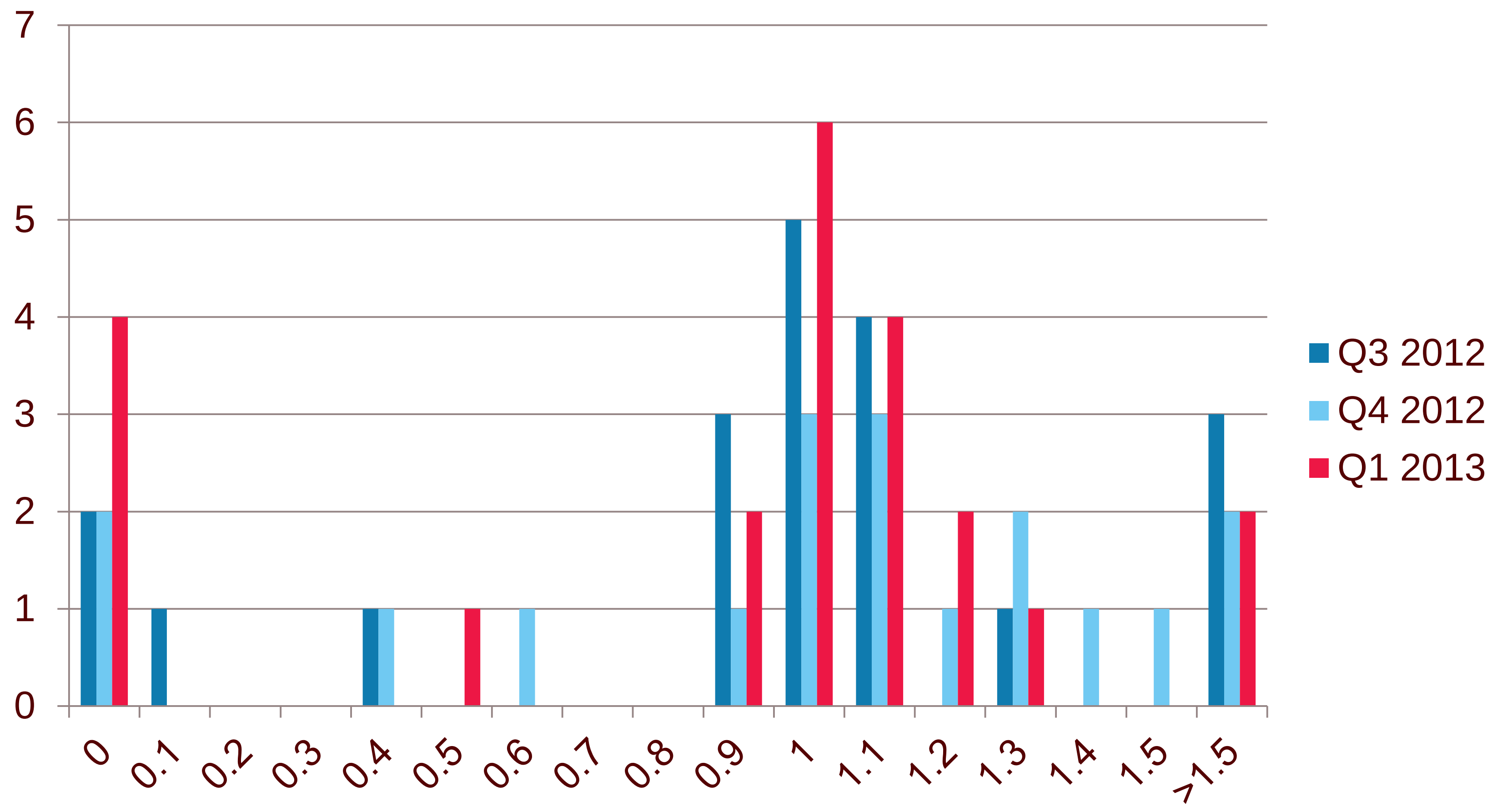
Futures trading volumes increased greatly c.f. 2011



Futures accounted for 50% of hedge contracts in 2012



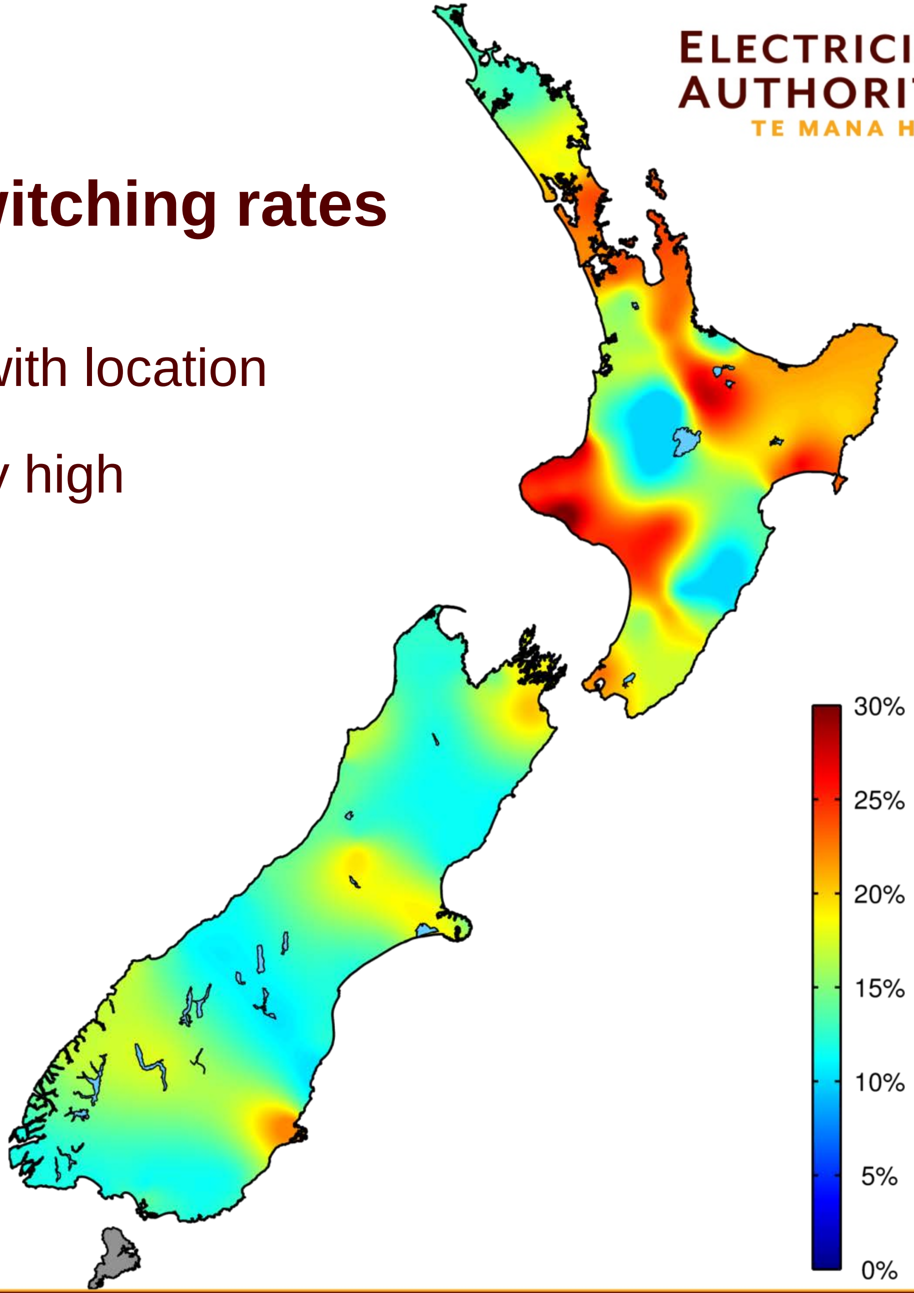
Stress test reveals 3 or 4 parties with no hedge cover



Regional consumer switching rates

Switching rates vary widely with location

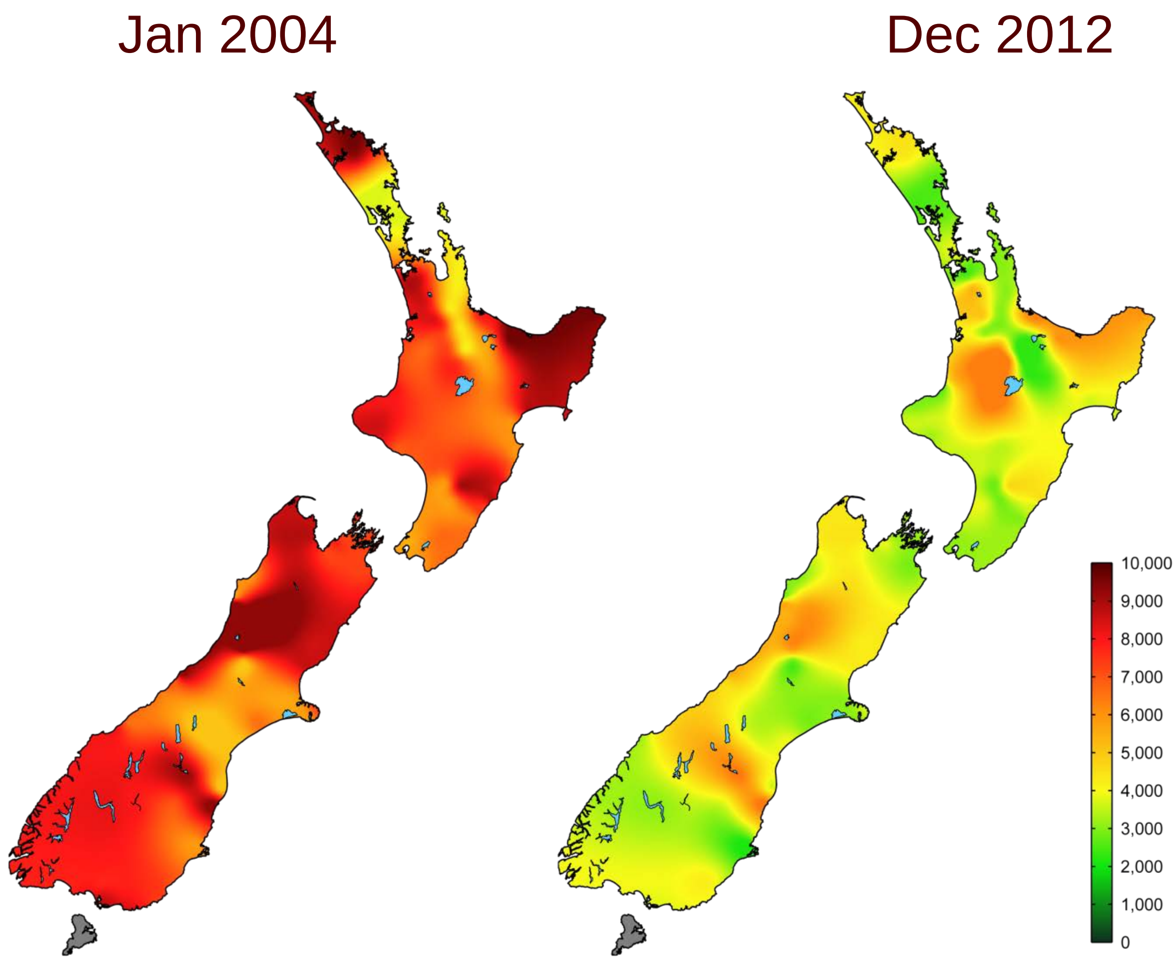
Taranaki switching rates very high



The Herfindahl-Hirschman Index (HHI)

- HHI for retail market = the sum of squares of each retailer’s market shares
- For example
  - HHI = 10,000 if there is a retailer with 100% market share
  - HHI = 2,000 if there are five retailers each with 20% market share
  - But HHI = 6,500 if one retailer has 80% market share and the other four each have 5% market share
- The HHI is a simple and partial indicator of the degree of competition
  - We are also assembling stats on other competition metrics, such as residual supply analysis

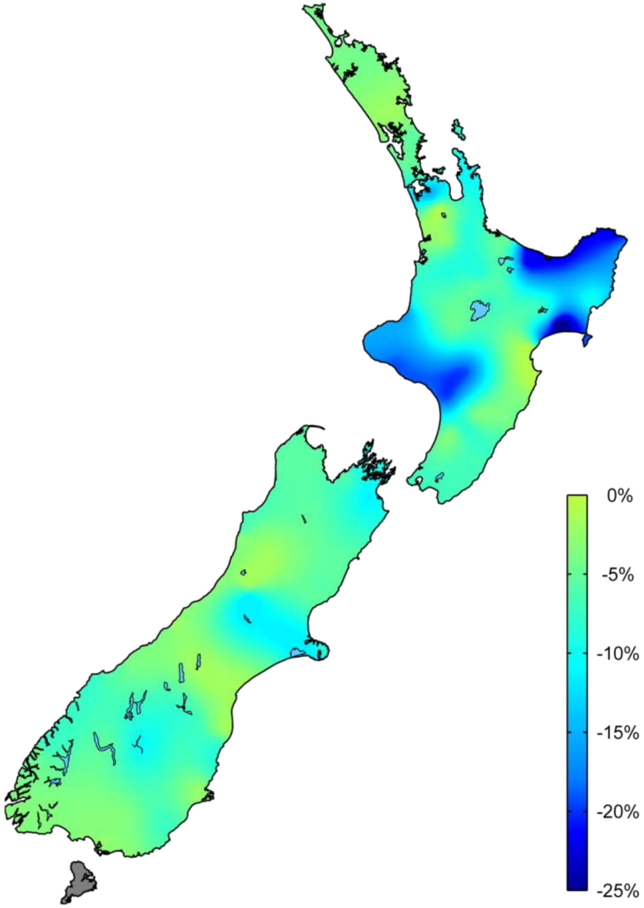
Large falls in HHI in many regions over last 9 years



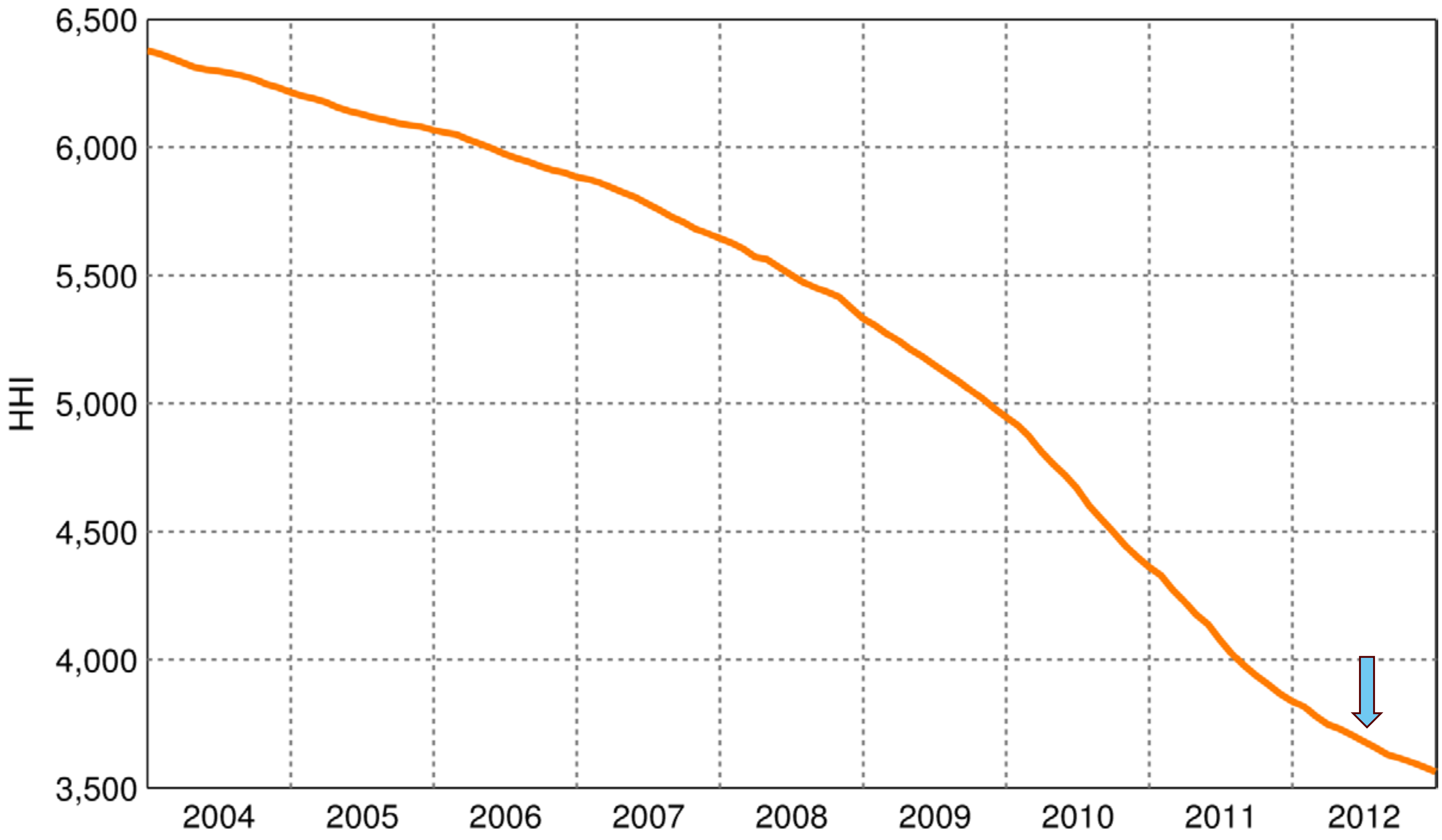
% change in retail HHI across the regions in 2012

HHI has decreased throughout NZ

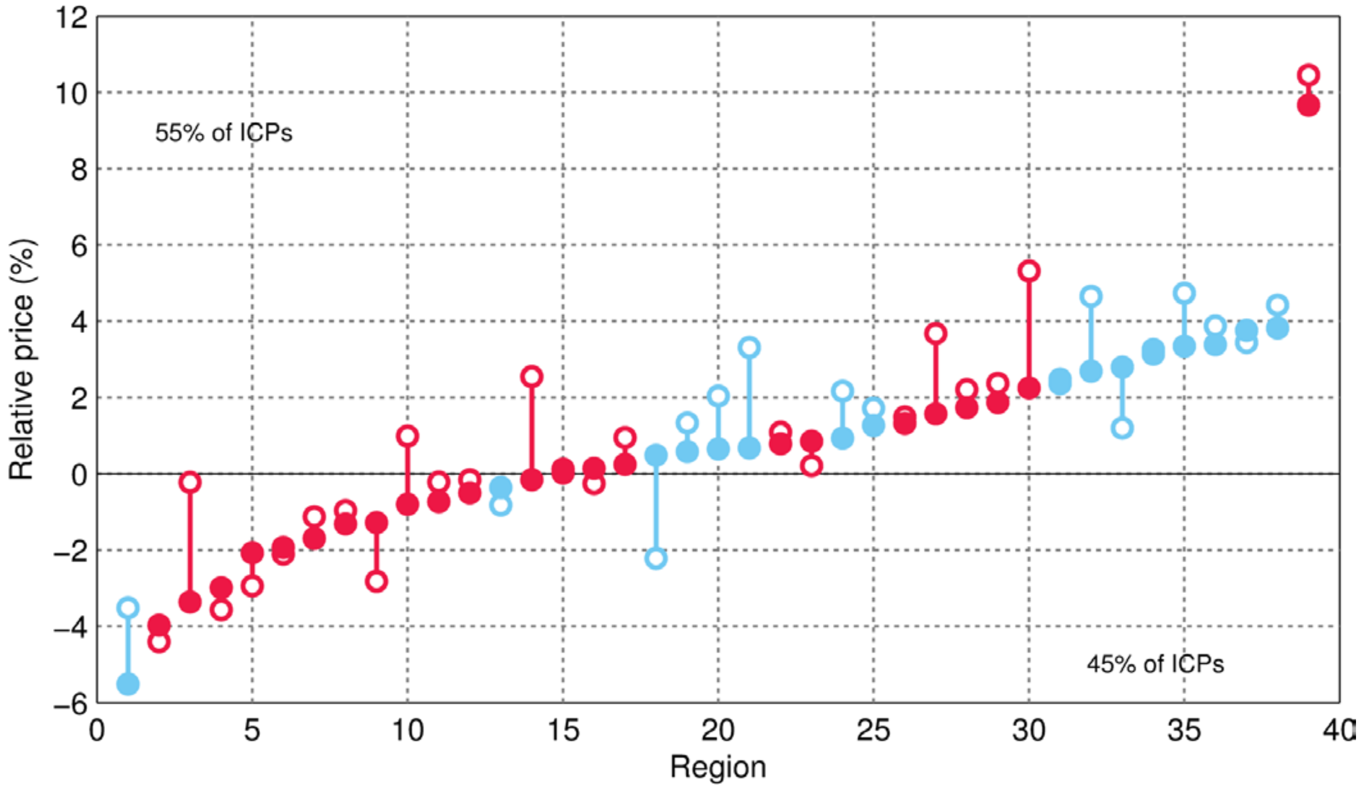
Big reductions in the dark blue areas



The overall HHI for the retail market continued to fall



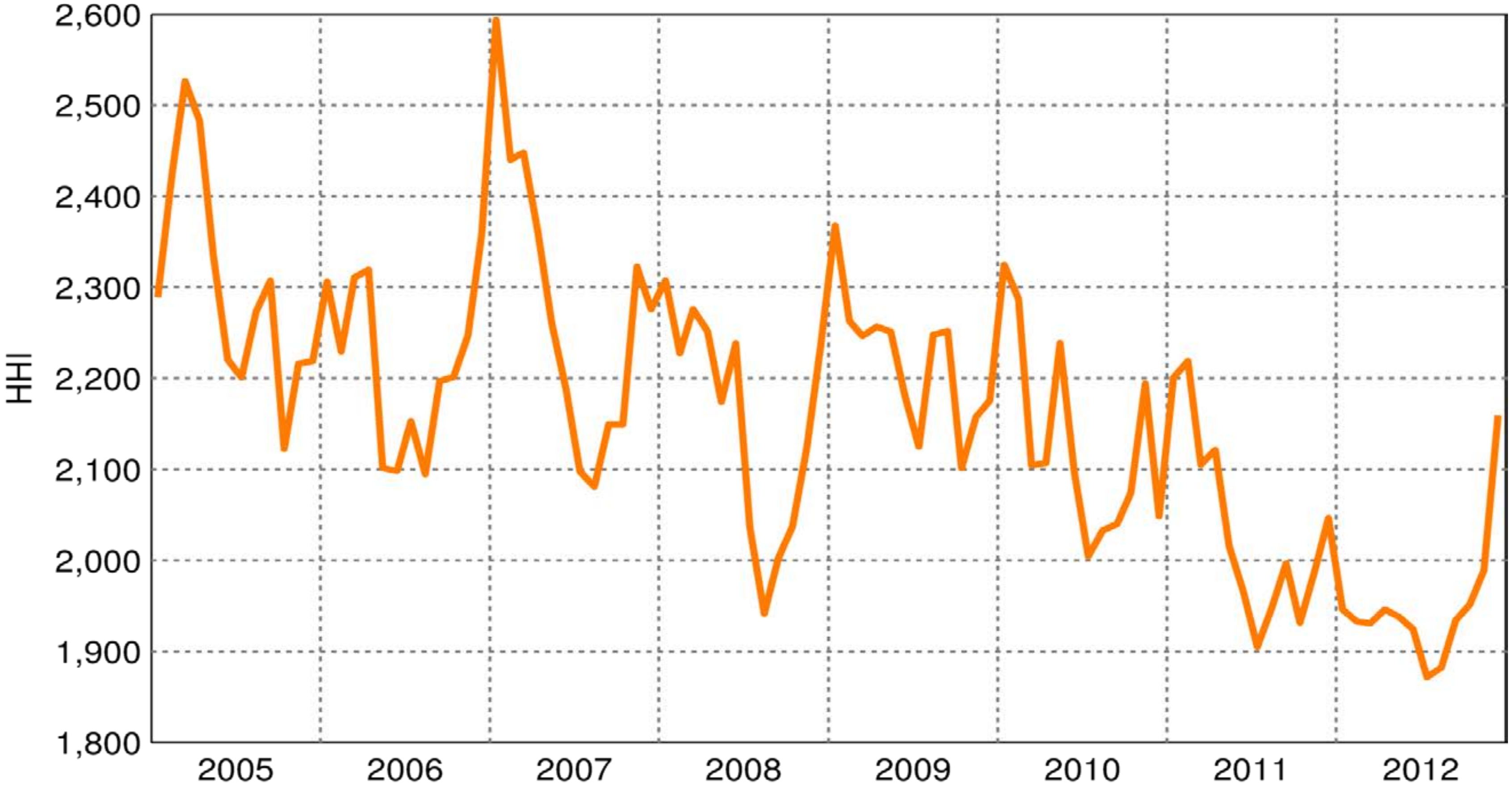
Consumers taking greater advantage of low offers



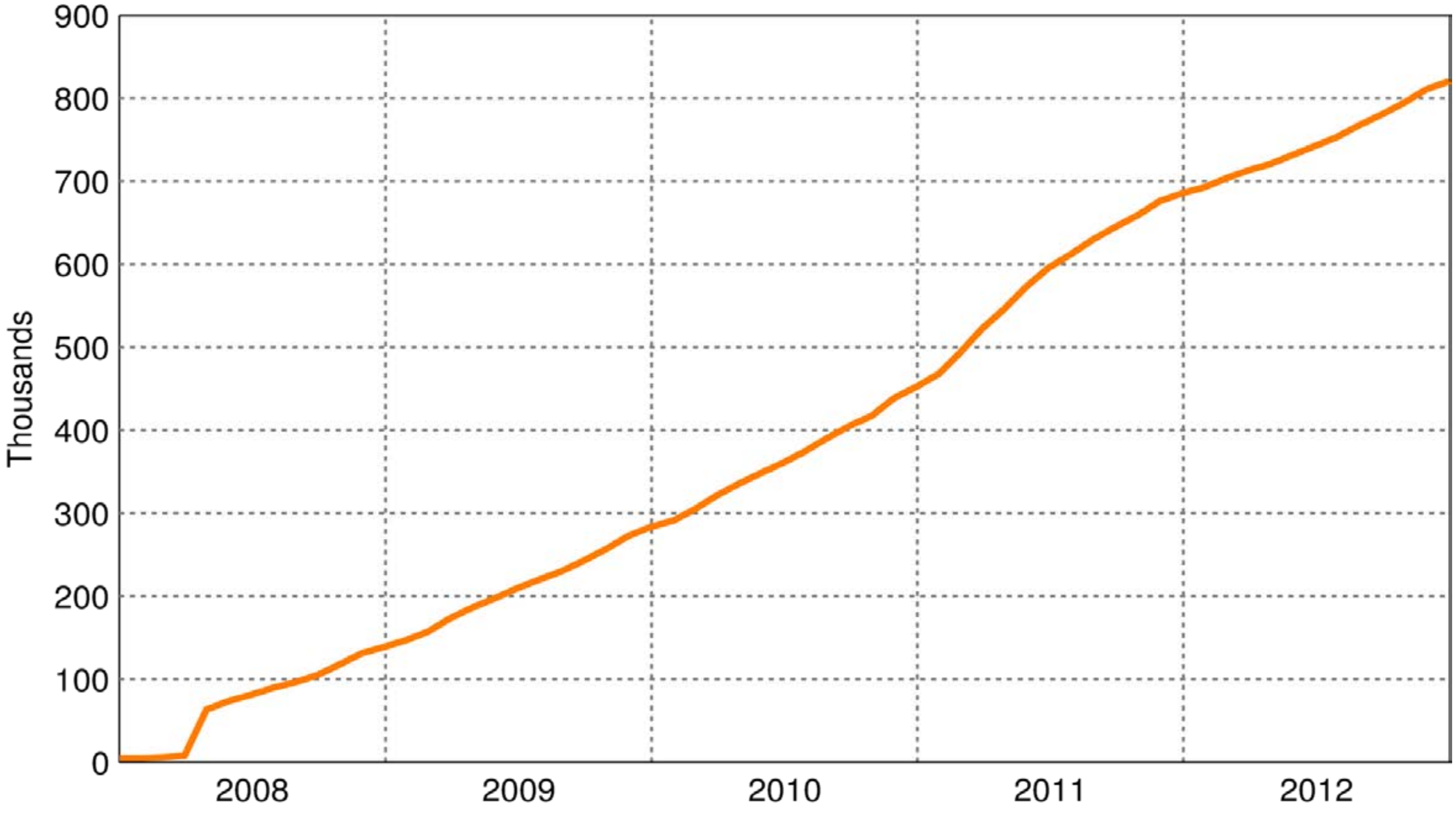
BOP region

Blue denotes South Island regions, red is North Island

Generation HHI continues a downward trend



Roll-out of smart meters continued at pace in 2012



Progress on current strategic priorities

General managers

Fraser Clark
Operations Development

Androula Dometakis
Corporate Services

Ross Hill
Legal & Compliance

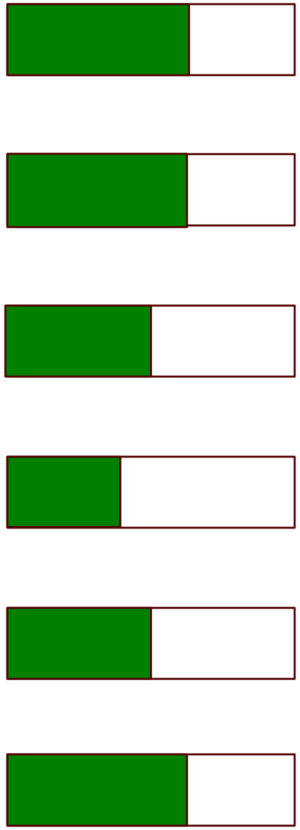
John Rampton
Market Design

Bruce Smith
Market Performance

Good progress on our strategic priorities so far

Progress

1. Successfully implement key systems projects
2. Implement top priority Code & MFM initiatives by 30 June 2013
3. Implement effective monitoring, information and education initiatives
4. Embed and enhance the effectiveness of advisory groups
5. Engage effectively with service providers and all stakeholders
6. Deliver productivity & quality gains at EA and service providers



Questions