

**Briefing to the Incoming Minister:  
Hon Simon Bridges**

**October 2014**

***This document has been proactively released. Redactions made to the document have been made consistent with provisions of the Official Information Act 1982.***

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## Key contacts

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## Upcoming events

### Upcoming events for the Minister

Event	Timing	See page
No Authority events for the Minister at this stage		

### Upcoming events for the Authority

Event	Timing
Publication of submissions on improving the transparency of consumers' electricity charges	14 October
Publication of Authority decision on saves and win-backs	21 October
Publication of consultation paper on appropriations and work priorities for 2015/16	28/29 October

## Section 1: Pending decisions or actions

### 2015/16 Budget: appropriations consultation

The Electricity Authority is cost neutral to the Crown as the appropriation to the Authority is funded by a levy on industry participants. We are required to consult annually with levy payers on our proposed appropriations for the coming financial year. We also use this consultation to engage on our proposed work programmes and key projects.

The consultation is expected to commence in late October 2014 for the 2015/16 appropriations. The appropriations consultation document will be sent to you prior to public release. We are planning to keep our appropriations forecasts for 2015/16 at the level approved in the 2014 Budget.

We will report to you on the results of the consultation and our recommended appropriations by early February 2015. The recommendations from this report feed into the Government's 2015 Budget process and our Statement of Performance Expectations for 2015/16. The Ministry of Business, Innovation and Employment (MBIE) coordinate our input into the overall Vote: Energy Estimates.

### Other pending decisions

#### Extended reserves: Order in Council and Regulation changes

In June 2014 the Authority completed Electricity Industry Participation Code 2010 (Code) amendments to implement a new approach to procuring extended reserves. Extended reserves is a 'last resort' mechanism where large blocks of demand are removed from the system to prevent electricity system collapse when major system assets fail at the same time (for example, if all generation units at Huntly failed at the same time). This 'last resort' mechanism would operate only in rare and extreme events.

Part of the implementation process includes establishing a new market operation service provider role: the extended reserve (ER) manager.

To complete the implementation of the new arrangements an Order in Council for the formation of the new service provider role and changes to the Electricity Industry (Enforcement) Regulations 2010 are required.

We are working to support the MBIE process relating to the Order in Council and regulation change. [Information withheld consistent with s9(2)(f)(iv) of the Official Information Act 1982].

#### Implementation of new settlement and prudential security arrangements

In December 2013 we made amendments to the settlement and prudential security part of the Code, creating a new Part 14A of the Code. These Code amendments take effect in March 2015. The new arrangements will stabilise and reduce the 'bond' that retailers (and other purchasers) deposit with the wholesale market. This means retailers will be able to service substantially more customers with the same amount of deposit.

Implementing these changes requires an amendment to the Electricity Industry (Levy of Industry Participants) Regulations 2010 to include the recovery of Part 14A costs.

From 12 August to 9 September 2014 we consulted on how the costs associated with the new Code should be recovered from levy payers. This was in conjunction with consultation on some Code refinements identified during the implementation process.

We are working to support the MBIE process relating to regulation changes.

[Information withheld consistent with s9(2)(f)(iv) of the Official Information Act 1982].

## Section 2: About us

The Authority was established as an independent Crown entity on 1 November 2010 by the Electricity Industry Act 2010 (Act).

We are required to have regard to Government Policy Statements presented in Parliament by the Minister of Energy and Resources (Minister), but are not required to give effect to them. There are currently no such policy statements.

The Authority is governed by a Board, which is supported by the Chief Executive and has approximately 70 staff. Please see appendix A for more information about the Authority Board and senior leadership team.

Section 15 of the Act sets us a clear objective:

to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

We progress this statutory objective by focusing on three areas of work: competition, reliability and efficiency.

**Figure 1 Electricity Authority's statutory objective**



The Authority's work is recognised by international regulators for the innovation and leadership we have shown in reducing barriers for retailers and encouraging consumer participation. In August 2014 the Authority hosted the Asia Pacific Energy Regulators Forum in Auckland. Authority staff are frequently called upon to present to international peers, most recently in Australia, Malaysia, Singapore and Taiwan.

## Funding and the levy

We are funded from Vote: Energy.

The Crown is reimbursed for the Authority's costs through a levy on industry participants. The levy also funds the Energy Efficiency and Conservation Authority's (EECA) electricity efficiency programme. The levy is administered by the Authority in accordance with

detailed formulae set out in the Electricity Industry (Levy of Industry Participants) Regulations 2010.

The Act prevents the Authority from charging service fees, which is in contrast to many other comparable regulators in New Zealand and overseas. The Authority would like to charge fees in certain circumstances to enhance the efficiency of the electricity industry.

## Our regulatory role

We are responsible for providing independent governance and regulation of the electricity industry.

## Market development

Our market development work focuses on promoting the competitive, reliable and efficient operation of the electricity system and markets.

The key tools at our disposal to develop the market are voluntary market facilitation measures and amending the Code.<sup>1</sup>

The Code came into effect on 1 November 2010, substantially the same as the previously existing market rules. The Code sets out industry participants' obligations across the supply chain: generation, transmission, distribution, retailing and the hedge market.

The list of industry participants also includes several industrial consumers because they buy electricity directly from the wholesale market and many of them provide services to it, such as making their load available for immediate interruption (called interruptible load). Residential consumers are not industry participants and therefore are not subject to the Code.

The Authority, in its own right, makes changes to the Code and monitors and enforces compliance with the Act, regulations, and the Code. We keep the Minister informed on a 'no surprises' basis.

**Figure 2 The Authority is a third-tier legislator**



There are several regulations relating to our functions, which are administered by MBIE<sup>2</sup>.

<sup>1</sup> Market facilitation measures (MFM) are non-Code initiatives such as guidelines or model arrangements or information campaigns or working directly with participants to facilitate desired results.

<sup>2</sup> For example, the Electricity Industry (Enforcement) Regulations 2010 and the Electricity Industry (Levy of Industry Participants) Regulations 2010.



## Working with stakeholders

We use advisory groups, made up of consumer and industry representatives, to analyse problems or issues assigned to them by the Authority's Board. The advisory groups make recommendations to the Board about options to address these issues. We also have a Security and Reliability Council (SRC) to provide advice on the performance of the electricity system, the performance of the system operator, and on reliability of supply matters. More information on the membership of these bodies is available in appendix B.

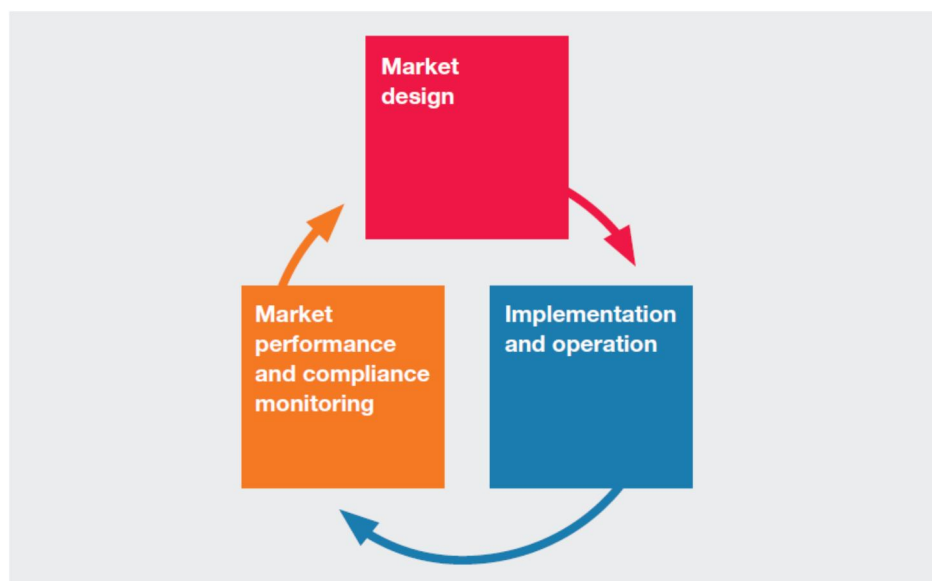
We receive significant input from industry stakeholders through our consultation processes. We also receive input from our contracted service providers, who have a major role in implementing Code amendments.

Once a Code amendment has been adopted by the Authority we work closely with the industry and our service providers to ensure the changes are effectively and efficiently implemented.

## Monitoring and compliance

Our market performance and compliance teams play a key role in assessing the effects of recent Code amendments. The market performance team carries out post-implementation reviews to assess whether the Code changes have had their intended effects on the market. The compliance team monitors industry participants to assess the industry's overall compliance with the requirements of the Act, regulations and Code are met.

**Figure 3** Our market performance cycle



We are also responsible for formally investigating and enforcing individual participant's compliance with the Act, regulations made under the Act, and the Code.

Our compliance activities focus on ensuring the Act, regulations, and the Code are accurately and consistently applied. Participants are obliged to report breaches and we may also investigate issues and trends to identify breaches and their causes.

Most compliance decision-making is currently delegated to the Board's Compliance Committee, except when the Board decides to refer cases to the independent Rulings Panel or take prosecution action through the Courts.

## Information and education

Our work in this area focuses on improving the availability of data, information and tools to interested parties, to improve awareness and understanding of how electricity markets function.

Through our market analysis work we identify behaviours that are potentially inconsistent with our statutory objective. This work also provides appropriate feedback into the market development work. We may also undertake reviews of irregular events on our own initiative or as requested by the Minister under section 18 of the Act.

## Our operational role

We are responsible for the day-to-day (real-time) efficient and reliable operation of the electricity system and markets.

We oversee the operation of the electricity system and markets through contracts with service providers<sup>3</sup>:

- **Transpower** manages the day-to-day operation of the electricity system as the system operator.
- **NZX** provides pricing, clearing and settlement, reconciliation, wholesale information and trading services.
- **Jade** operates a registry that facilitates the switching of customers from one retailer to another.
- **Energy Market Services (EMS) Limited**, a commercial business group within Transpower, provides the Financial Transmission Rights (FTR) manager service.
- We carry out the **market administrator** role in-house.

Supporting the operation of the markets includes the following functions:

- maintaining the register of industry participants
- granting individual exemptions to the Code, where justified
- investigating and resolving alleged undesirable trading situations
- performance oversight of security policy and operation, including approving or declining security of supply policies and plans proposed by the system operator
- carrying out responsibilities for supply shortage declarations
- supporting the SRC.

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<sup>3</sup> More information about service providers is included in appendix A.

## Accountability documents

We provide draft statements of intent (SOI) and statements of performance expectations (SPE) to the Minister for comment in accordance with the Crown Entitles Act 2004.

We also publish an annual work programme of our key projects that affect the electricity industry. We publish quarterly reports on progress against the work programme. The work programme and reports are provided to the Minister for information.

Annual reports are provided to the Minister for tabling in Parliament. We provide the Minister with a draft of the annual report for information as part of our fourth quarter reporting.

We provide 'no surprises' briefings to the Minister as necessary.

A copy of the work programme for 2014/15 is appended to this report.

## Foundation documents

Our foundation documents are intended to promote regulatory predictability and credibility. They provide consumers, investors and industry participants with a transparent view of how we conduct our work.

Our published foundation documents are:<sup>4</sup>

- an *Interpretation of the Authority's statutory objective*, which sets out our interpretation of section 15 of the Act
- an *Advisory Group Charter*, specifying our policy on advisory groups and the SRC
- a *Consultation Charter*, setting out our policy and processes for consulting interested parties on proposals to amend the Code and other matters, and the Code amendment principles we and the advisory groups will adhere to in considering proposals to amend the Code.

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<sup>4</sup> Available at [www.ea.govt.nz/about-us/strategic-planning-and-reporting/foundation-documents/](http://www.ea.govt.nz/about-us/strategic-planning-and-reporting/foundation-documents/)

## Section 3: Results for consumers

As noted earlier, section 15 of the Act requires the Authority to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

In simpler terms, the key issues are:

- Will the lights stay on?
- Are prices reasonable?
- Do consumers have choice?
- Is innovation occurring?

### Will the lights stay on?

New Zealand has a high proportion of hydro-electric generation, but a relatively low level of storage capacity in its hydro lakes. This means that our electricity supply can be vulnerable in 'dry years'. The Authority and previous Ministers have introduced a series of regulatory interventions to address security of supply issues.

These initiatives were tested during one of the driest six months on record in 2012 and further moderately dry spells in the summer months of 2013 and 2014. Hydro lake levels were carefully managed during all these periods. This meant there were no calls for public savings campaigns and no lobbying through the media for ad hoc measures to suppress market prices. Most importantly, it meant New Zealand consumers could be more confident they will enjoy an uninterrupted electricity supply. We will keep a vigilant eye on this area to ensure this positive trend continues.

### Are prices reasonable?

Electricity prices are made up of two main components:

- **Energy**—the proportion of costs associated with generation and retail services. This is the competitive part of the market which is overseen by the Authority.
- **Lines**—the transmission and distribution networks. These are monopolies, subject to regulation by the Commerce Commission.

There are currently three different price measures for electricity:

- MBIE sales-based residential electricity price (SQREP)
- MBIE Quarterly Survey of Domestic Electricity Price (QSDEP)
- Statistics NZ electricity index.

The most useful measure of electricity prices paid by households is MBIE's sales-based residential electricity price.

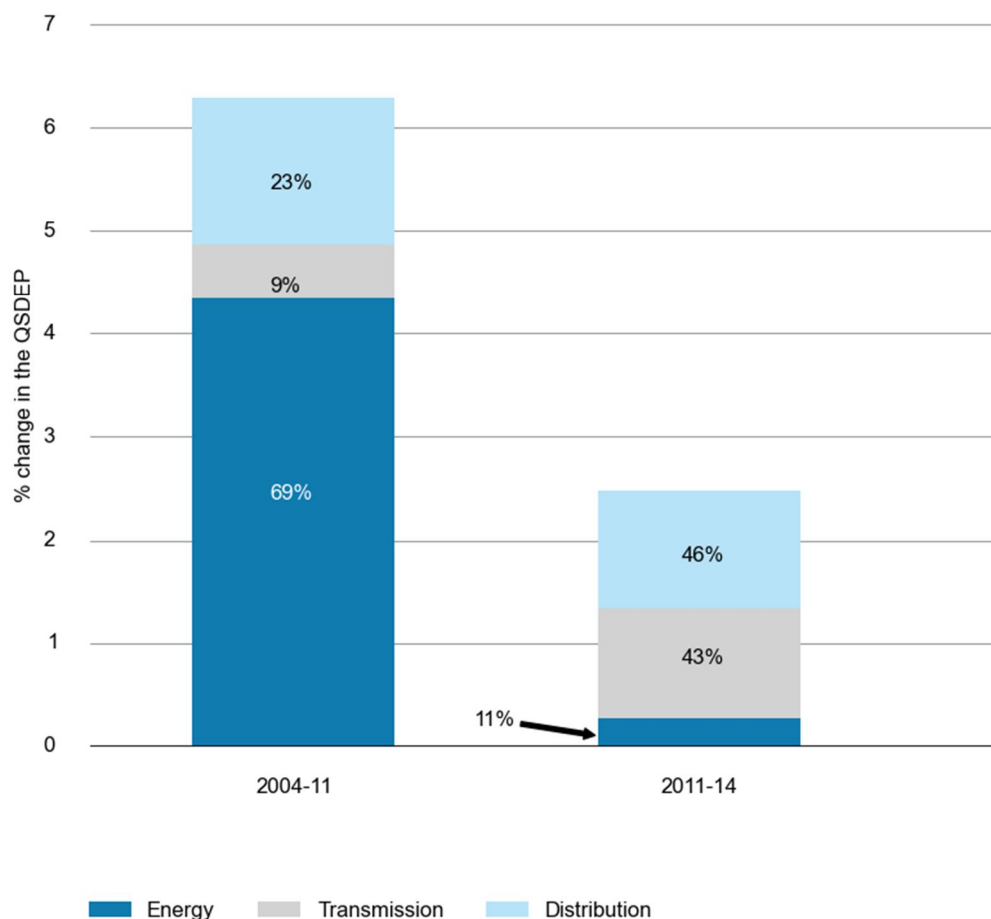
This data shows residential prices rose 2.0% in the quarter ending June 2014 compared to the previous June quarter. Prices for the competitive part of the industry actually fell by

0.7% over this period whereas prices for the regulated-monopoly part of the sector increased by 5.9%.

Significant pro-competition initiatives have been underway since mid-2011, such as the Authority's *What's My Number* advertising campaign which began on 29 May 2011. The initial impact of enhanced competition shows up in the prices that retailers offer to new customers. As the competitive pressure on retailers persists it becomes harder for them to charge their existing customers at a materially higher price than their new customers, and so the average price paid by households is also constrained over time.

The QSDEP measures average prices offered by retailers. This data shows that prices offered by the competitive parts of the electricity sector increased much more slowly in the last three years than in the seven years prior to the adoption of the pro-competition initiatives. It also shows that the bulk of the increases in offer prices over the last three years were driven by the regulated monopoly part of the sector.

**Figure 4 Annual percentage changes of components of electricity bills (based on QSDEP)**

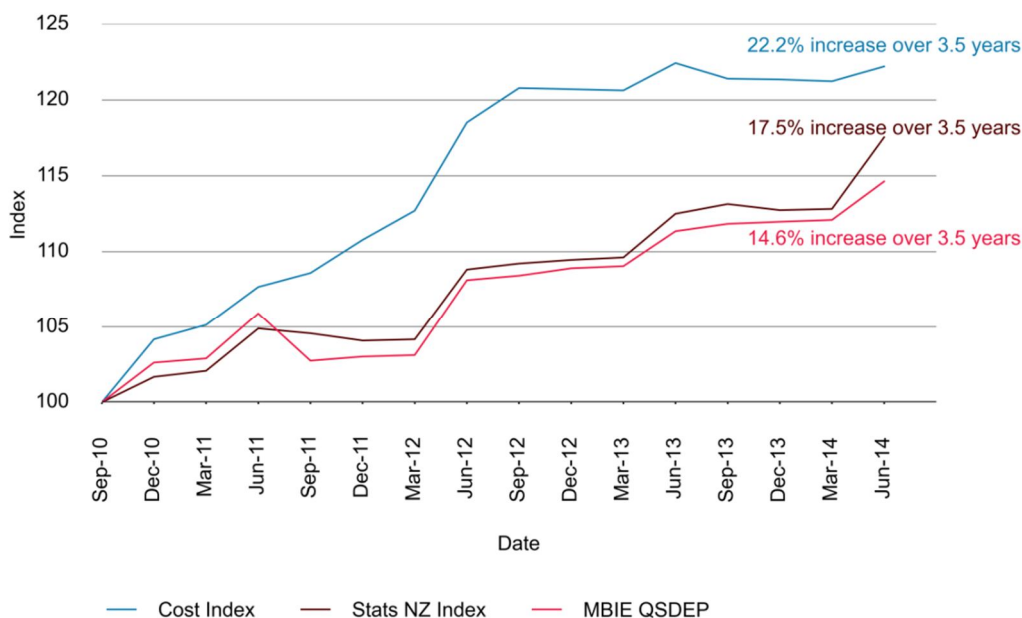


Source [www.med.govt.nz/sectors-industries/energy/energy-modelling/data/prices/electricity-prices](http://www.med.govt.nz/sectors-industries/energy/energy-modelling/data/prices/electricity-prices)

As expected, the new sales-based price data (that measures the prices that households actually pay for electricity) shows a lagged impact from the pro-competition initiatives. The annual rate of increase for the competitive part of the industry was 2.6% for the last three years, declining to 1.3% in the last two years and then to -0.7% in the last year.

It is also important to consider prices relative to costs. Higher costs put upward pressure on prices. Over the last three and a half years prices have increased at a slower pace than costs for an independent retailer. The costs (based on a cost index developed by the New Zealand Institute of Economic Research) are illustrated in the blue line in the graph below. This trend again indicates that competitive forces are constraining price increases.

**Figure 5 Movements in two price indicators and the NZIER cost index**



## Do consumers have choice?

We run the award-winning *What's My Number* marketing campaign, which aims to provide consumers with information about their ability to switch power companies, the ease of switching, and the potential savings that can be made on their power bills.

An international report in December 2013 showed that New Zealand had the highest switch rate in the world in 2012 at 18.9%.<sup>5</sup> Switching numbers reaching a 33-month high in March 2014, with nearly 40,000 account changes taking place. In total just over 200,000 consumers switched during the first six months of 2014.

High switch rates, however, are not a robust indicator of competition. For example, a low switch rate arising from retailers offering very similar tariffs would also be consistent with intense competition by retailers.

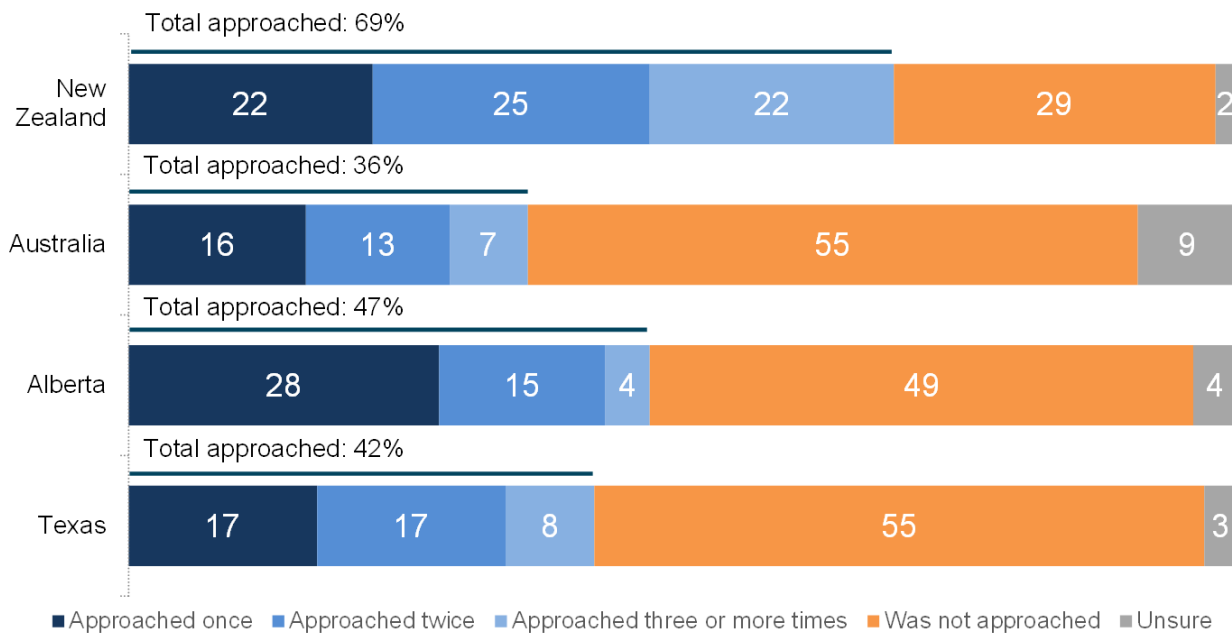
The Authority surveys consumers annually, asking them how many times they have been approached in the last two years by a different electricity retailer to switch to them. This survey measures how proactively retailers are competing for customers. The survey shows retailers have become much more proactive since the *What's My Number* campaign began in 2011, with a 43% increase in the number of respondents in 2013 reporting they had been approached by two or more retailers in the previous two years.

<sup>5</sup> <http://www.vaasaett.com/2013/12/the-most-active-energy-markets-in-2013-revealed/>

We have recently compared these results with other competitive electricity markets. The retail market in Texas is widely considered to be the most competitive in the United States. The proactivity of New Zealand retailers was substantially higher than that of Texas and the other countries in the survey (see the blue shaded areas in figure 6).

**Figure 6 Proactive pitching to consumers (UMR Research – international benchmarking research October 2014)**

Survey question: How many different power companies have approached you about switching in the past two years?



There are now 14 independent electricity retailers retailing through 25 brands to New Zealand residential consumers. This is a higher number of retailers than ever before.

Flick Energy entered the retail market in August 2014 and there are another five parties building and/or testing their systems. We are aware of a dozen other parties considering entering the New Zealand market.

There is also an increasing range of tariff options available to consumers, giving increased flexibility and allowing consumers to choose the options that best meet their needs.

## Is innovation occurring?

Greater competition in the retail sector is resulting in greater innovation.

Some recent retail innovations we have observed include:

- **Genesis Energy's** trials for introducing different prices for three different periods of the day (peak periods, off-peak periods and a shoulder period) for residential consumers.
- **Flick Energy's** tariff to residential consumers, which passes half-hourly spot electricity prices onto consumers, plus a fixed daily and variable charges to cover their retailing costs and lines charges.

- **Pulse Energy's** offer to residential consumers to cap the energy component of their prices for five years.
- **Trustpower** has recently started to bundle energy with telecommunications and internet services.
- New energy management services offered to consumers, including **Mercury Energy's** Good Energy Monitor (called GEM) and **Genesis Energy's** MyCoach offer which allow consumers to have greater control over their energy usage.
- New billing offerings including **Mercury Energy's** Glo-Bug, which is a pre-pay service that uses the smart metering system to quickly and visibly inform customers they're running out of credit. The Glo-Bug product instantly disconnects customers when they run out of credit and instantly re-connects them when they've paid money into their account, avoiding costly re-connection fees.

Much of this innovation has been enabled by the rollout of smart meters. Just over half of New Zealand's two million metering installations have already been replaced with a smart meter. Contracts have been let for a further half a million smart meters to be installed.

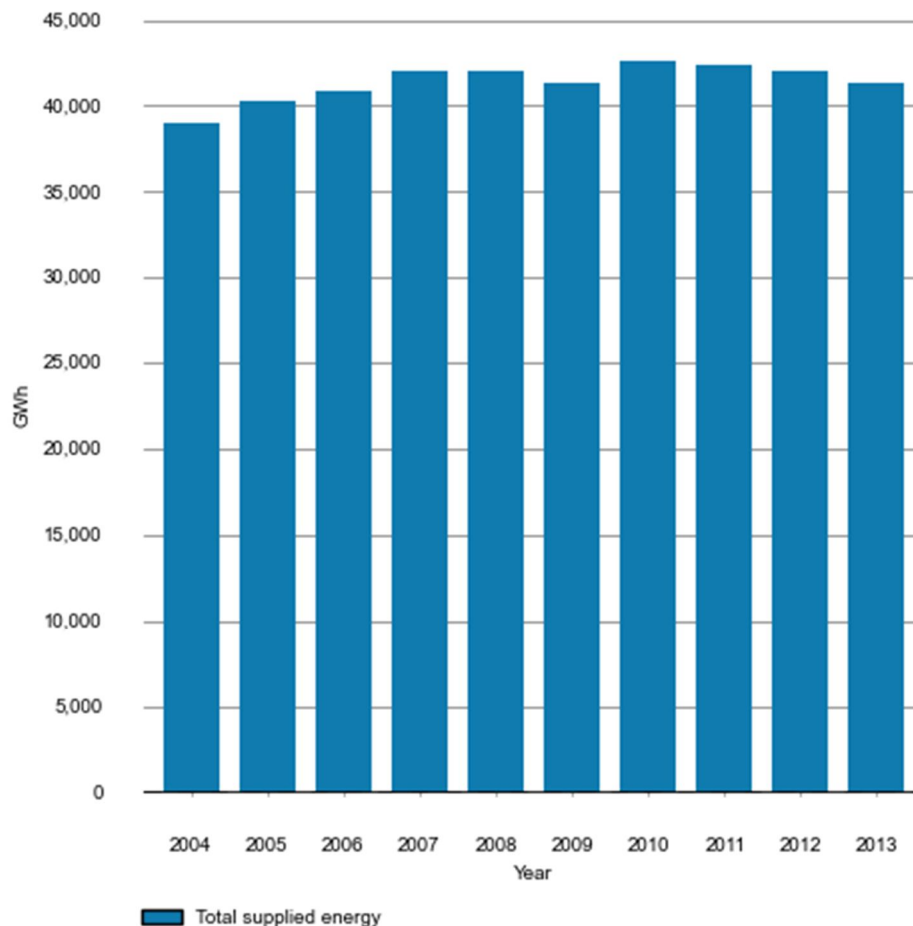
New Zealand's rollout of smart meters is unique around the world in that it is being managed competitively by electricity retailers without any cost to Government or consumers. Government mandated approaches have been adopted in most other countries with smart meters, which have often led to much higher costs and some rollouts have stalled. Australia is now seeking to adopt New Zealand's approach in this area because of our success.



## What do future price trends look like?

There has been flat electricity demand since 2007, and it has been declining slightly since 2010; this is illustrated in the chart below.

**Figure 7 Annual demand since 2004**



The electricity futures market sets prices for electricity contracts for up to four years ahead. Futures prices have been subdued since mid-2012, due to weak demand and excess generation capacity arising from investment decisions in the mid-to-late 2000s. The low futures prices suggest market participants believe spot market prices will remain low in the years ahead, which implies the energy component of retail prices should remain flat.

The Commerce Commission released its decision on Transpower's price-quality path for the five years beginning on 1 April 2015, except for the maximum revenues allowed by Transpower. These maximum revenues will be included in Transpower's final price-quality path determination that will be published by 28 November. It has also released its draft decision on the reset of price-quality paths for 16 of the 17 distributors under its price control regime (the remaining distributor Orion has a customised price-quality path resulting from the Christchurch earthquakes). If carried through to its final decision, the combined outcome is a slight decline in the overall lines charges under the Commerce Commission's control, but with some sizeable increases and decreases in various regions.

We believe all these factors will contribute to relatively flat electricity prices over the next few years.

## Section 4: About the electricity sector

### The electricity supply chain

In New Zealand, most electricity is produced by electricity generators distant from where electricity is used. This is often because of the geographical location of energy sources, for example, rivers used for hydro-generation, geothermal fields or the location of good wind generation sites.

Around 90 per cent of New Zealand's electricity passes through the high voltage transmission system that spans the country and is known as the national grid.

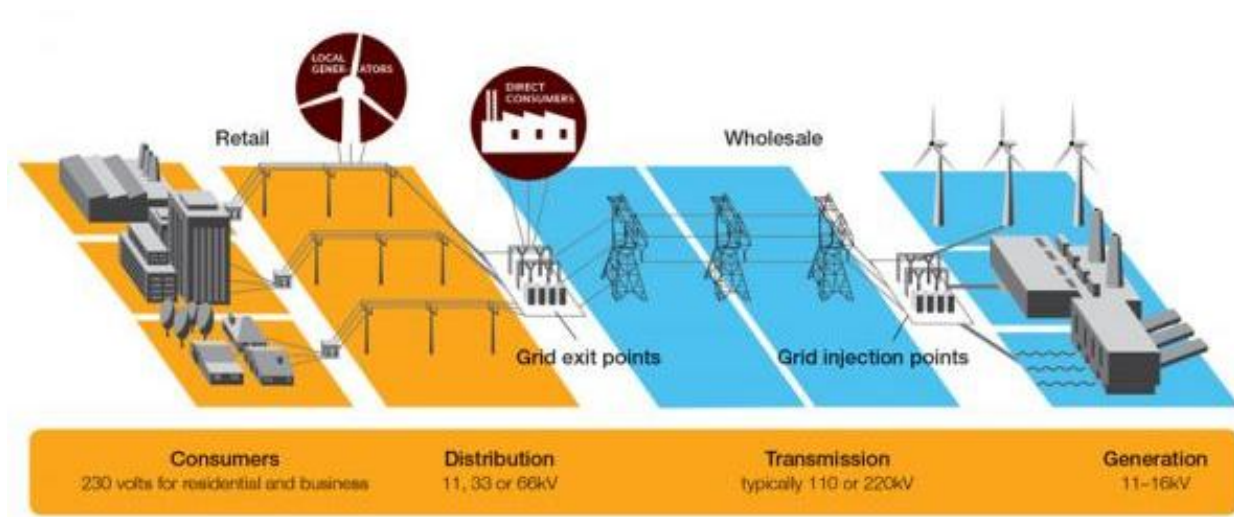
The transmission system delivers electricity at high voltage to substations in each part of New Zealand. Large cities may have several substations serving them, and in a few cases, electricity is directly supplied to large industrial consumers.

Local distribution systems take the power delivered to each substation and deliver it at lower voltages to homes and businesses.

The remaining 10 per cent of electricity that doesn't pass through the transmission system is generated by plant that is directly connected to the local distribution system or, in the case of some large industrial customers, by their own on-site generation.

The diagram below summarises the various parts of the electricity supply chain.

**Figure 8** The electricity supply chain in New Zealand



### Sector statistics

Electricity is one of the most capital intensive industries, and one that is vital to all New Zealanders.

There are:

- 1.7 million residential consumers
- 150,000 commercial consumers

- 65,000 agriculture, forestry and fishing consumers
- 35,000 industrial consumers.

Almost **\$6 billion** a year is spent on electricity.

## Other roles in the electricity sector

We are one of several agencies with distinct roles in the electricity sector. We work closely with these other agencies.

Other important agencies in this space are:

- The **Ministry of Business, Innovation and Employment (MBIE)** is the policy adviser to the Government. Its role includes advising on Acts and regulations. MBIE also has a monitor role in respect to the Authority.
- The **Commerce Commission** regulates suppliers of electricity lines services under the Commerce Act 1986. All electricity businesses serving residential consumers are subject to the Fair Trading Act.
- The **Electricity and Gas Complaints Commissioner** deals with complaints between individual consumers and retailers. The EGCC is funded by member companies, but is otherwise independent of the industry.
- The **Energy Efficiency and Conservation Authority (EECA)** works to improve the energy efficiency of New Zealand's homes and businesses and encourage the uptake of renewable energy.

## Section 5: Our focus for the year ahead

Our 2014/15 work programme was published in early August. It is attached as appendix C.

### Promoting retail competition: reducing barriers and facilitating consumer participation

Our focus for the remainder of this year and 2015 remains on our work to further enhance retail market competition to deliver long-term benefits for consumers. Our aim is to develop a market where retailers can enter and exit with ease and to ensure there is a level playing field on which to compete for customers. We are also aiming to make it easy for consumers to find and choose the best tariff plans for their needs, understand and respond to tariff changes and make other electricity decisions.

Four of our top six key projects in the 2014/15 work programme target improvements to retail market competition. Our work programme targets both the supply-side and demand-side of the retail market. Supply-side projects aim to reduce barriers to retailer entry and expansion, for example, the hedge market development project and the project on saves and win-backs. Demand-side projects aim to enhance consumer participation and engagement in the retail market, for example, the *What's My Number* campaign and the retail data project.

Evidence indicates that those consumers who are engaged and shop-around are able to secure good deals from retailers. One of our key aims is to encourage more consumers to be engaged which would create a virtuous cycle with engaged consumers driving retailers to deliver more consumer-focussed services, which in turn will create more engaged consumers.

Our consumer participation initiatives are underpinned by the *What's My Number* campaign, which we ran in conjunction with Consumer NZ and the Ministry of Consumer Affairs (now part of MBIE) since 2011. The campaign has greatly enhanced retail competition by encouraging consumer participation.

Our key projects in this area are:

#### Retail data

The purpose of the retail data project is to improve consumer access to consumption and tariff data, and make it easier for their agents to access that data. Improved consumer access to this information is expected to enhance the ability of consumers to engage in the buying process, which in turn is expected to drive retailers to compete, innovate and seek efficiency gains to meet the needs of consumers.

**Why?** Poor access to retail data could inhibit consumer decision-making, market monitoring and reporting.

#### *What's My Number* campaign: promoting consumer switching

*What's My Number* is a marketing campaign that aims to provide consumers with information about their ability to switch power companies, the ease of switching, and the potential savings that can be made on their power bills.

The initial *What's My Number* campaign ran from May 2011 to April 2014. In April 2014, the Authority decided to continue the campaign through to June 2017. Funding was approved in the 2014 Budget. The focus of the refreshed campaign is to encourage consumers to make a habit of checking they are on the best power deal for their circumstances. The campaign will be further enhanced once consumers have easier and quicker access to data through the retail data project.

**Why?** Evidence indicates that a targeted version of the campaign could further raise consumer awareness, understanding and motivation to participate in the market.

## **Improving transparency of consumers' electricity charges**

We are concerned that a lack of transparency about electricity charges (which becomes more evident when price changes are announced) is resulting in reduced consumer engagement and confidence in the market.

We have consulted on a proposal to require retailers to provide information to consumers about any price changes in a standard format, so that the nature and reasons for these changes are clearly presented. The proposal would also require retailers and distributors to consult each other on their media statements about price changes. The consultation paper also considers whether to require retailers to adopt consistent language to reduce complexity for consumers when they're comparing retailers.

**Why?** Better information increases consumer engagement and should also promote accountability across the supply chain by requiring better explanations of the drivers of price changes.

## **Competition effects of saves and win-backs**

The purpose of this project is to address any adverse effects on retail competition of saves and win-back practices. A save occurs when a losing retailer convinces a customer to cancel an incomplete switch. A win-back occurs when the customer completes the switch, but the defending retailer later persuades the customer to return. We are concerned that these practices are detrimental to retail competition because they significantly increase the cost of customer acquisition, which impacts on the ability of new entrant and expanding retailers to gain customers. We have completed consultation on this project and expect to release a decision on the proposal very shortly.

**Why?** New entrant and growing retailers are critical drivers of competition and innovation in the retail market. They need to be confident they are operating on a level playing field.

## **Hedge market development**

The hedge market allows generators and purchasers to manage the risk of price movements in the spot market by entering into hedge contracts. The market has grown significantly since late 2010 when the Act required us to facilitate measures to increase hedge market activity. The development of the hedge market has been led by participants with support from the Authority and has encompassed a wide range of initiatives. We are committed to maintaining this momentum and further developing the value of the hedge market to participants.

**Why?** We want a good availability of a range of hedges to ensure a level playing field for all retailers and generators. Any initiatives undertaken in this area are expected to reduce barriers to entry and expansion for retailers.

## Promoting competition in wholesale markets

Our work programme includes a range of projects to improve wholesale market competition, particularly in ancillary services. Ancillary services are additional services provided to the electricity market to keep the transmission system in balance so that it doesn't collapse.

### National markets for ancillary services

**Frequency keeping**—there are currently separate markets for frequency keeping in the North and South Islands, and so the aim is to develop a national market for frequency keeping. Frequency keepers are fast acting generating and load stations that are able to maintain continuous balance between load and dispatched generation.

**Instantaneous reserves**—there are also separate North and South Island reserves markets and so the aim is to develop a national market for reserves. Instantaneous reserves comprise two main sources: (1) spare generating capacity that is able to rapidly increase output if the power system experiences a sudden loss of a large generating unit and (2) interruptible load, which is when a consumer (typically a large industrial consumer) offers to have its demand cut instantly if the power system experiences a sudden loss of a large generating unit.

**Why?** These projects would allow parties in the North Island to compete in the South Island and vice versa. We also expect there to be efficiency gains as national markets should reduce the total quantity of these services that need to be procured.

## Promoting efficient price signals

Efficient pricing, especially the efficient pricing of transmission and distribution services, is about developing arrangements for efficiently allocating the costs of these monopoly services.

### Transmission pricing review

The Commerce Commission determines the overall revenue Transpower is allowed to charge for transmission services, which amounted to \$879m in 2013/14, and rises to \$990m by 2019/20.

The Authority sets the guidelines for Transpower to allocate its revenue requirements among its customers, which is called the transmission pricing methodology (TPM). The Authority has been reviewing the TPM guidelines since early 2011 and expects to issue a final decision in 2015.

**Why?** We are reviewing the current arrangements to better promote operational and investment efficiency in the transmission sector. This is a significant matter for all consumers and industry participants.

## **Research project: effects of low fixed charges on competition, reliability and efficiency**

We plan to undertake a research project to see whether the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations) promote the long-term benefits of consumers. Industry participants and consumer representatives have highlighted issues with the LFC Regulations. Parties have also raised these concerns with officials at MBIE, and the Department of the Prime Minister and Cabinet.

**Why?** We are undertaking this project under section 16(1)(g) of the Act—to undertake inquiries into any matter relating to the electricity industry. MBIE is responsible for the administration and amending of the LFC Regulations. We expect to provide MBIE with the results of the research project to inform its consideration of the outcomes achieved by the LFC Regulations.

## **Distribution pricing review**

We will be considering ways to improve the efficiency of distribution pricing arrangements to achieve better operational and investment efficiency in the distribution sector and the broader electricity market.

**Why?** The need to ensure distribution networks are priced more efficiently is becoming more pressing due to technological change, particularly the growth in the installation of photovoltaic (PV) distributed generation and greater consumer use of demand response tools.

## **Tendering and renegotiating key market services**

### **Tendering for market operation services**

The Authority has contestable contracts for a suite of market operation services to run the wholesale and retail electricity markets. Collectively, these contracts cost the Authority \$10.6 million in 2013/14. The Act requires the Authority to outsource these services, except the minor role of market administrator, which the Authority currently undertakes.

The Authority has made an in-principle decision to tender for all of the well-established market operation roles: the registry, pricing manager, clearing manager, reconciliation manager and the wholesale information and trading system contracts. The FTR manager is also a contestable role but it was only established (and tendered) in 2013.

**Why?** The current contracts have been in place for more than six years. An independent assessment by PA Consulting has confirmed that there is value in revamping some of the service specifications and testing the market for new technical solutions.

### **Renegotiation of system operator agreement**

Unlike the market operation services discussed above there is no contestability for system operator services. The Act specifies that Transpower is the system operator.

The system operator is responsible for the real-time operation of the electricity system to ensure that the amount of generation matches the level of demand in real time (often referred to as 'keeping the lights on'). The system operator is the largest of all of the market operations service provider roles, and represents more than 60 per cent of the

Authority's operating costs (nearly \$40 million in 2014/15). The majority of our wholesale market initiatives are also required to be implemented through Transpower's IT systems.

**Why?** The current contract, called the system operator service provider agreement (SOSPA), predates the establishment of the Authority, so does not align the activities of the system operator with the Authority's statutory objective. Also it does not contain appropriate commercial incentives for performance. The Authority and Transpower have agreed to renegotiate the SOSPA. The new SOSPA is expected to be operational from 1 July 2015.



## List of appendices

- Appendix A: Our Board, leadership team and organisational structure
- Appendix B: Membership of the Rulings Panel, Security and Reliability Council and advisory groups
- Appendix C: 2014/15 Work Programme

## Appendix A Our Board, leadership team and organisational structure

### Our Board

The Authority Board is made up of between five and seven members appointed by the Governor-General. Members hold office for a term of up to five years and may be reappointed.

Authority members are Dr Brent Layton (Chair), Susan Paterson and Elena Trout (appointed for terms of five years, expiring 1 November 2015) and David Bull and Hon. Roger Sowry (reappointed for terms of five years, expiring 1 June 2017).

#### Dr Brent Layton (Chairperson)



Dr Layton is a former senior fellow and chief executive of the New Zealand Institute of Economic Research (NZIER).

He has been a director or chairman of organisations in sectors as diverse as banking and finance, health, scientific research, electricity, food processing, transport and information technology.

As a consultant, Dr Layton's work has spanned macro and microeconomics and corporate finance. Much of his work has involved regulatory economics and responses to regulatory change.

In 2009, Dr Layton chaired the Ministerial Review of the performance of the electricity market. Dr Layton is also Chair of Swimming New Zealand.

#### David Bull



David's experience in our electricity sector includes two decades as a power system engineer at the Electricity Corporation of New Zealand and more recently a term on the board of the Electricity Commission.

He is experienced in central government processes and stakeholder and community relationships, having previously worked for Local Government and Community Services in the Department of Internal Affairs.

He was also a Wellington City Councillor or Wellington Regional Councillor for 15 years.

## Susan Paterson



Susan is a pharmacist and MBA graduate from London Business School.

She has senior management experience in a number of companies in New Zealand, and during a decade in the USA and Europe, where she was also a strategy consultant with Boston-based Index Group.

Susan was project director for the Wholesale Electricity Market development Group (WEMDG) in the early 90s, a director of EECA and spent over 8 years on the Transpower Board from 1999.

Susan has 17 years' board experience and holds a number of directorships and board positions. Current board roles include:

- Chair of Airways Corporation
- Chair and shareholder of Theta Systems Limited
- Director of Goodman Property Aggregated Limited
- Director of Abano Healthcare Limited
- Director of Les Mills NZ Limited
- Committee member of Auckland Branch Institute of Directors
- Council member of IANZ
- Board member of Housing New Zealand
- Director of Indoor Sports & Leisure
- Chair of The Home of Cycling Charitable Trust.

## Hon. Roger Sowry ONZM



Roger has extensive experience in the public sector and served on the board of the Electricity Commission.

He was a Member of Parliament from 1990 to 2005. From 1996 to 1999, Roger was Minister of Social Welfare and Associate Minister of Health. When he retired from Parliament in 2005, Roger became chief executive of Arthritis New Zealand.

Roger is currently a private consultant with Saunders Unsworth specialising in the management of public policy issues.

Roger is also Chair of TeamTalk Limited.

## Elena Trout



Elena is a professional engineer and holds a Master of Civil Engineering. She has extensive experience in the planning, development and operation of assets in the infrastructure, transport and energy sectors and has held a number of senior management roles in a diverse range of organisations.

She has specialised in establishing business strategies, procurement and delivery of large projects. Having spent almost six years as a director of Transpower, Elena has extensive experience in the electricity sector and its governance.

Current board roles include:

- Electricity Efficiency and Conservation Authority
- Marsden Maritime Holdings Limited.

Elena is also Vice President of the Institution of Professional Engineers of New Zealand, Chair of the Advisory Board of Eco Stock Supplies Limited and an independent director of Harrison Grierson Consultants Limited.

## Board committees

The Board has three committees: the Audit and Finance Committee, the Compliance Committee and the System Operations Committee.

The **Audit and Finance Committee** advises on the quality and integrity of the Authority's financial reporting, including managing the relationship with the external auditor. It also considers whether appropriate governance, policies and operating processes are in place to identify and manage risk and oversees and assesses the internal audit process. Members are Susan Paterson (Chair), Elena Trout and Hon. Roger Sowry.

The **Compliance Committee** makes decisions on alleged breaches of the Act, various regulations and the Code. The Committee also considers applications for exemptions to the Code. It determines appropriate enforcement responses, whether settlements should be approved or further investigation undertaken and makes recommendations to the Board regarding the laying of formal complaints with the Rulings Panel and instigating prosecutions. Members are Hon. Roger Sowry (Chair), David Bull and Susan Paterson.

The **System Operations Committee** oversees the performance monitoring of the system operator, identifies any emerging system security risks and addresses any other matters relating to the system operator's obligations under the Code. Members are David Bull (Chair), Dr Brent Layton and Elena Trout.

## Organisational structure and management

### Chief Executive: Carl Hansen



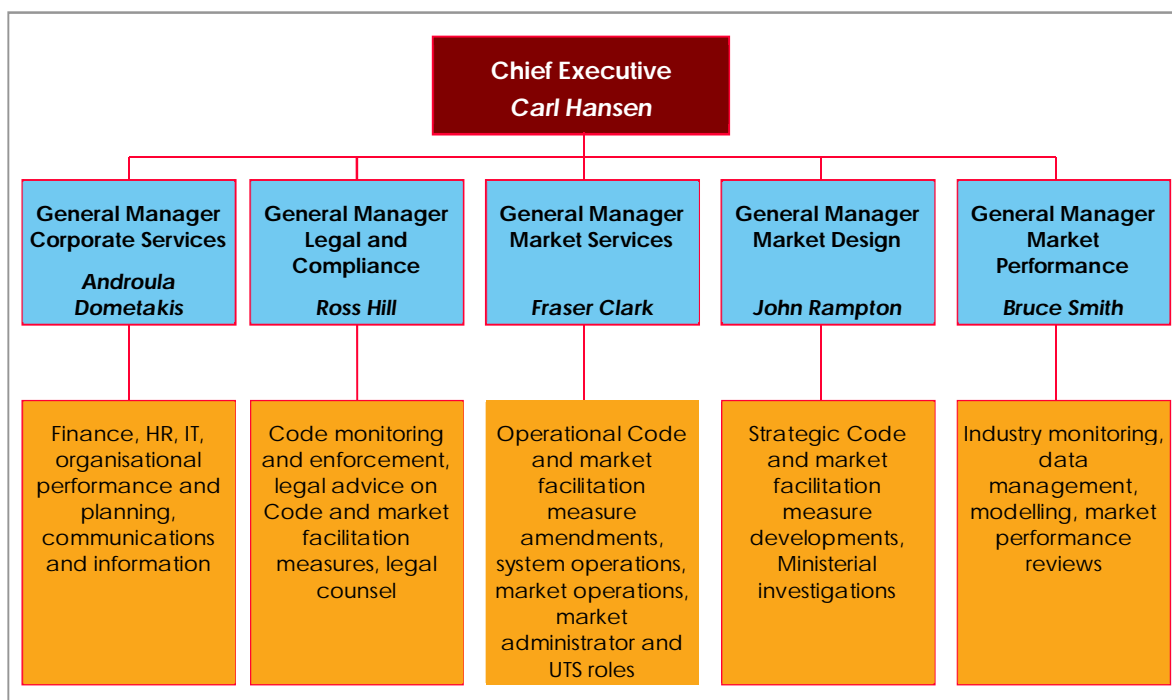
Carl Hansen has been Chief Executive of the Electricity Authority since it was established in November 2010.

Previously, Carl was involved in the evolution of the New Zealand electricity market as a senior executive and director, independent adviser and economist.

He has chaired sector technical and advisory groups and acted as principal adviser to a number of industry bodies.

Carl spent almost a decade with market services company M-co, originally as chief economist and then as chief executive.

Figure 9 Organisational structure



## Our statutory functions

Section 16 of the Act sets out our functions. Broadly, these are to:

- register industry participants
- develop and administer the Code
- monitor and enforce compliance with the Code, Act and the Electricity Industry (Enforcement) Regulations 2010 (Regulations)
- facilitate market performance through information, best-practice guidelines, and related services

- undertake sector reviews
- act as Market Administrator and contract with market operation service providers
- promote consumer switching
- monitor sector performance against the Authority's statutory objective.

Section 18 of the Act requires us to carry out reviews at the written request of the Minister on any matter relating to the electricity industry. To date, no reviews have been requested.

## Service providers

The **system operator** is responsible for the real-time operation of the power system, including scheduling and dispatching electricity, in a manner that avoids undue fluctuations in frequency and voltage on the transmission grid. System operator responsibilities include giving instructions as to when and how much electricity to generate (ie, it dispatches generation) so that injections of electricity into the system match uptake by electricity consumers at each moment in time. The system operator also publishes the generator dispatch schedules, and is responsible for the operation of security of supply forecasting, monitoring and emergency management functions.

The system operator is also responsible for ongoing security monitoring and emergency management. The system operator can seek funds from the Authority's security management appropriation if needed for:

- increased monitoring and management responsibilities in the event of an emerging security situation
- planning and running an official conservation campaign.

The Authority is responsible for approvals in respect to use of the security management appropriation.

The **wholesale information and trading system** (WITS) is used to transfer information among wholesale market participants, especially the uploading of bids and offers.

The **reconciliation manager** allocates volumes of electricity to generators and purchasers. It uses metering information supplied by participants and calculates unaccounted for electricity.

The **pricing manager** calculates and publishes final prices, which are used by the clearing manager to calculate invoices.

The **clearing manager** invoices and settles physical electricity sales and purchases identified by the reconciliation manager, ancillary service payments and any financial hedges required to be taken into account in the prudential calculation. It also maintains prudential security requirements.

The **registry** is a database that identifies every customer point of electricity connection to a local or embedded network. It enables customer switching between traders and contains key information for the reconciliation process.

The **FTR manager** was established in 2013. The FTR manager is charged with running regular auctions of financial transmission rights (FTRs), which are a locational hedge product.

The Authority carries out the role of **market administrator**, providing several operational and administrative services to the market under the Code.

For more information on service provider contracts, which include detailed performance specifications and reports, see the operations section of our website: [www.ea.govt.nz](http://www.ea.govt.nz)

## **Appendix B Membership of the Rulings Panel, Security and Reliability Council and advisory groups**

### **Rulings Panel**

The Rulings Panel is the industry dispute resolution and disciplinary body. It was established under the Electricity Governance Regulations 2003 and continues under the Act.

The Governor-General appoints panel members.

The Rulings Panel is Peter Dengate Thrush (Chair), Geraldine Baumann (Deputy Chair), Sue Roberts, Nicola Wills, and John O'Sullivan.

### **Security and Reliability Council**

The Act sets requirements to establish the Security and Reliability Council and other advisory groups.

The Security and Reliability Council provides independent advice to the Authority on the performance of the electricity system and the system operator and reliability of supply issues. Membership as at 30 June 2014 is Mike Underhill (Chair), Dennis Barnes, Albert Brantley, Barbara Elliston, Vince Hawksworth, Judi Jones, Bruce Turner, Guy Waipara and Erik Westergaard.

### **Advisory groups**

The Authority has established two standing advisory groups: the Wholesale Advisory Group (WAG) and Retail Advisory Group (RAG).

Members of the WAG are John Hancock (Chair), Neal Barclay, John Carnegie, Stephen Peterson, Bruce Rogers, Richard Spearman, Graeme Everett, Alan Eyes and Chris Jewell. Phillip Anderson was appointed to the group from 1 August 2014.

Members of the RAG include Peter Allport (Chair), Sue Chetwin, James Munro, Nathan Strong, Ewan Gebbie and Alan McCauley. Three new members were appointed to the group from 1 August 2014: Allen Davies (GreyPower); James Tipping (Trustpower); and Nicholas Robinson (Contact Energy).

### **Additional advisory and technical groups**

From time to time other advisory and technical groups have been established. Information about these groups is available in the Annual Report and on our website.

More information about the Security Reliability Council, advisory groups and additional technical groups is available on the Authority website at:  
[www.ea.govt.nz/development/advisory-technical-groups/](http://www.ea.govt.nz/development/advisory-technical-groups/)



## Appendix C 2014/15 Work programme