

19 January 2018

Energy Markets Policy Team  
Ministry of Business, Innovation and Employment

By email: [energymarkets@mbie.govt.nz](mailto:energymarkets@mbie.govt.nz)

Dear Energy Markets Policy Team,

## **Electricity Pricing Review proposed terms of reference**

The Electricity Retailers' Association of New Zealand (ERANZ) welcomes the opportunity to provide feedback on the Electricity Pricing Review proposed terms of reference. A number of our members will also separately respond to identify their specific issues.

### **Introduction**

The electricity sector faces a time of great change and opportunity for New Zealand. It is timely to assess the performance of the sector, the regulatory framework that governs it, and whether either will be both fit-for-purpose and be able to make the most of opportunities now and in the future. As technology, new products and services, and consumer demands change, we believe there are opportunities for New Zealand to continue to improve energy outcomes for all customers, and in particular low-income households. The backdrop is also one of an increasing push to lower carbon emissions fuel sources, of which electricity is one, and greater investment to meet a 100% renewable electricity generation target<sup>1</sup>.

Our electricity sector continues to demonstrate remarkable performance with sustainability, reliability, competitiveness, affordability and security of supply. We are regarded as having one of the best-performing electricity sectors in the world. New Zealand is ranked in the top 10 in the world for renewability, reliability and affordability<sup>2</sup> and our electricity markets are among the most highly competitive in the world. Last year, the International Energy Agency (IEA) judged New Zealand to be "...a world leading example of a well-functioning electricity market, which continues to work effectively."<sup>3</sup> The IEA also remarked upon New Zealand's highly cost competitive renewables sector noting that geothermal, hydro and wind energy were achieving ever greater proportions of electricity

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<sup>1</sup> under normal hydrological conditions

<sup>2</sup> World Energy Council, Energy Trilemma Index 2017; <https://trilemma.worldenergy.org>

<sup>3</sup> Energy Policies of International Energy Agency Countries: New Zealand 2017 Review, page 101; <https://www.iea.org/publications/freepublications/publication/EnergyPoliciesofIEACountriesNewZealand2017.pdf>

and heat supply without the need for subsidies or government support. The IEA said “*This performance is a world-class success story among IEA member countries.*”<sup>4</sup>

Therefore, we note that the focus of the review and its outcomes need to be carefully considered so as not to unintentionally destabilise or distort a system that requires certainty for long-term investment decisions across all parts of the sector. But, there are always aspects that can be improved on, especially as the market, products and services evolve.

We offer some suggestions for the draft terms of reference with the intention they will enhance the opportunity for successful outcomes and the ability for the sector to engage with the process of the review.

### 1) We welcome the broad scope of the Terms of Reference

If the focus of the review is to be whether the price paid to the end-consumers is fair and equitable, then we support that to confirm this, the review must take into account all of the input costs and decisions that influence that final price the consumer faces.

We encourage the review to take a customer-centric and forward-facing position. In our view, to only analyse the status quo or against a retrospective frame, risks leading to recommendations that fail to address the new challenges facing the industry and regulators.

### 2) Sequencing of the stages of the review

Given the broad scope of the review, we would recommend that the focus areas for the review could be prioritised to enable the review process to achieve its aims in the requisite timeframe.

We consider the terms of reference should set out in more detail specifically what the strategic objectives are for the review, and identify how the review would identify a successful outcome. Fundamental principles for the market or the sector then need to be established to provide a framework against which that objective would be measured. It will be important for the review to keep the fundamentals of the energy trilemma in balance – those of security, environmental sustainability, and affordability.

A review of this nature has the potential to create uncertainty in the sector at a time when the need for the industry to move quickly to respond to changes in technology, for investment in renewable generation, and the entry of international players into our energy sector has never been greater. We therefore support those undertaking the review to proceed with the work as quickly as is reasonably possible.

In addition to the staging of the review, we suggest that immediate priority be given to areas where there is a clear consensus in favour of reform. One such area is the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations. There is broad consensus now that these regulations cause pricing distortions that negatively impact many low-income, high-energy use families. The regulations may also be affecting New Zealand’s transition to a low-emissions

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<sup>4</sup> Ibid, page 182

economy by creating a pricing structure that can inhibit the uptake of electric vehicles and incentivise the use of non-renewable fuels such as gas.

### 3) What is the definition of “fair and equitable”?

Given that the focus of the review is an examination of whether the price paid by the end-consumer is “fair and equitable”, we believe that these terms must be clearly defined so that those undertaking the review fully understand the problem definition to work towards, and for the sector to know on what basis it is being examined. The industry has experience of ‘simple’ fixes that lead to long term costs, misdirected investment, and some groups of consumers subsidising others, that it would hope to avoid from this review.

We appreciate that this terminology has been used in the Memorandum of Understanding between the Electricity Authority and MBIE dated September 2014, which states that “*the Authority’s focus is on promoting competition, reliable supply and efficiency in the electricity industry for the long-term benefit of consumers. Consideration of fairness and equity issues is the responsibility of the MBIE as is overall energy policy*”. We are not, however, aware of a definition for those terms in the context of the electricity sector.

We note that the Electricity Authority assesses whether prices are “reasonable” which is defined as when “*prices... reflect the costs of the services consumers use, so that consumers get the benefits of the efficiency gains and their own choices can be more efficient.*”<sup>5</sup> The World Energy Council uses the metric of energy equity meaning “accessibility and affordability”<sup>6</sup>. This highlights that there are complexities in applying different metrics to the issues. Therefore clear definitions and a statement of objectives would be desirable, as well as an understanding of which other government departments might also be responsible for meeting those social policy objectives.

### 4) 100% renewable electricity generation target must be factored in to this review

New Zealand needs an electricity sector that is sufficiently dynamic and attractive to new investment to enable us to meet the Government’s 100% renewable electricity generation target<sup>7</sup>, as well as low-carbon economy targets. These targets will naturally have an effect on the electricity sector, and on prices to end-consumers. This needs to be factored in to an assessment of current and future market structure, as well as future technologies and regulatory frameworks.

### 5) What is in the scope of the review needs to be consistent with the issue being considered

New Zealand has a tradition of governments reviewing the electricity sector’s performance and taking measures to address issues of concern. Over the last 18 years the sector has had a number of reviews, including the Electricity Industry Enquiry in 2000, the Post Dry Winter Review in 2001, the Electricity Market Review in 2006, the Review of Electricity Market Design in 2008, and the most recent Ministerial review of the market in 2009. Each review has reaffirmed the fundamental

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<sup>5</sup> Electricity Authority Annual Report 2016/17

<sup>6</sup> World Energy Council, Energy Trilemma Index: <https://trilemma.worldenergy.org/>

<sup>7</sup> in a normal hydrological year.

structure of the industry which has delivered the performance as highlighted in the IEA report. However, on each occasion the changes driven from the review have had an impact on the costs and drivers for the sector, and each has needed time for those changes to bed down. There is already a significant amount of work underway in the market at this time that is driving innovation, competition and efficiencies for customers.

We would therefore recommend that the review not explicitly exclude data from certain periods of time, or specific issues (such as those that have been the subject of intense scrutiny). The analysis of data may potentially need to go further back in order to provide a counterfactual and establish context. If the review is to be a future-facing and customer-centric one, and to assess whether the regulatory framework will be fit for purpose and the settings correct, then it will be necessary to consider how different parts of the sector are regulated, even if that had already been the subject of scrutiny or litigation. We therefore consider it would be preferable for those undertaking the review to use their discretion to determine what information is relevant and in scope to achieve the objectives for the review.

#### 6) Other points that we suggest could be clarified

We recommend that these other points are clarified:

- Those undertaking the review need to define what is meant by the term “customer segments” which is used throughout the draft Terms of Reference. This term can mean different things to different parts of the sector. Retailers have different ways of categorising their customer groups, as do distributors with their customers and consumers. Therefore, we recommend the review define what is meant when this term is used.
- We are not clear what is meant by “long-standing government policy on rural pricing”. We recommend this is defined in the final terms of reference.
- It is also not clear what is meant to be the focus of the clause on “informational asymmetries”. Could this clause be explained further to make it clearer what is the problem that will be examined?

#### 7) Achieving fair and equitable outcomes requires a holistic approach

The final point we wish to raise is that, as Statistics New Zealand recently reported<sup>8</sup>, energy hardship is a complex relationship between poor housing quality, energy costs, low income, inefficient heating and other appliances, and behaviour. If the review is to successfully consider what fair and equitable outcomes means in the context of electricity then a holistic approach to possible policy responses is required, including social policy responses. As ERANZ and individual members, we have already been engaging with a variety of organisations to improve outcomes for customers, including Ministry of Health, Ministry of Social Development, Housing New Zealand, Oranga Tamariki, EECA and

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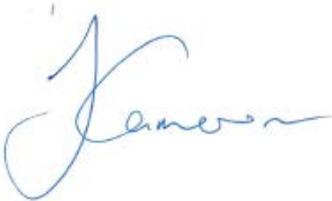
<sup>8</sup> Statistics New Zealand, *Investigating Different Measures of Energy Hardship in New Zealand*, Sept 2017

others. We would like to continue to work with the government in the development of these in the context of this review for the benefit of end-consumers.

We agree with the expectation expressed in the draft terms of reference that there should be wide consultation on issues and draft findings. As stated at the outset, we welcome the opportunity to be engaged and for the industry to continue to be involved and consulted as the stages of the review are developed.

Thank you for your consideration of this letter. We look forward to working with MBIE in the process and offer our assistance as required.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jenny Cameron', is positioned above the typed name and title.

Jenny Cameron  
**Chief Executive**  
**Electricity Retailers' Association of New Zealand**