

Speech notes - *Dr Brent Layton*

Stakeholder cocktail function

3 March 2015, 5.30-7.30pm, Top of the Town, Pullman Hotel, Auckland

On behalf of the Board of the Electricity Authority it is my pleasure to welcome you here this evening. My name is Brent Layton; I am the Chair of the Authority. I am joined here tonight by my Board colleagues: Elena Trout; David Bull; Susan Paterson; and Roger Sowry.

Today, I'd like to reflect on some of the highlights for the electricity market in 2014, and some of the trends we're observing in 2015.

I reflect back to this time last year.

At that time, debate around alternative models for the electricity market was in full swing.

Mighty River Power and Meridian Energy had been partially privatised but their performance on the stock exchange was still in its infancy and Genesis Energy was yet to be floated.

We had 22 electricity brands and 14 electricity retailers, with Budgie and Grey Power Electricity the fresh, new brands in the market.

Energy demand was stagnant.

The last Quarterly Survey of Domestic Electricity Prices of 2013 had shown that prices for residential consumers had increased by 3% over the calendar year but it was difficult to know what that meant as the statistic didn't comprehensively take into account the full range of discounting we were observing in the market.

And what's more, the Quarterly Survey of Domestic Electricity Prices measured prices that retailers offered to new customers, not the prices that consumers were actually paying.

We now have more robust measures of electricity prices produced by MBIE. The new Quarterly Survey measure shows that the competitive component of household electricity prices fell by 0.6% for the 2014 calendar year.

This is good news for consumers, but consumers care mostly about the total they pay rather than the individual components. Overall prices increased by 2.4% due to rises in transmission and distribution charges.

One year on and the focus of debate has shifted to questions about how the market is delivering value to consumers through innovation and new technology, and the efficiency of electric vehicles and household solar generation. The debate has also shifted back to issues of reliability due to events like the Penrose outage.

But, first off, looking back at last year, we saw very positive activity on the wholesale market with an increase in trading in ASX hedges and also in fixed price contracts.

The new futures products which started in 2013 have all been implemented and the monthly contracts have started to be reasonably actively traded.

We'd obviously like to see even more activity in the futures market and some other hedging products introduced, and I'm aware there is

interest from other parties in this occurring. It will be interesting to see developments unfold in 2015.

I'd like to acknowledge the good work of generators who managed another dry summer using the spot and hedge markets.

Interestingly hydro generation in 2014 actually exceeded 2013 levels despite this dry weather.

The electricity demand picture in 2014 was interesting.

In 2014 demand was 1.2% higher than in 2013. In the first half of the year it was relatively stagnant but during the last six months of the year it was 2.7% up.

It is too early to say whether this growth in demand towards the end of the year merely reflects one off factors like the rebuild of Christchurch and the dry weather increasing irrigation use or the extent to which it also reflects factors that may have more sustained effects such as the growth in GDP, higher population growth or the lower trend in prices.

The econometric modelling we undertook during 2014 confirmed the close link between GDP and prices and electricity demand. Time will tell.

Last year Kiwis with almost every retailer had the opportunity to enjoy prompt payment discounts, many around the 15% mark.

There were also plenty of customer incentives available, with credits of between \$100 and \$200 often offered to customers to switch between retailers.

We saw the big four electricity retailers lose market share in 2014, and the medium-sized retailer group – which includes Trustpower, Nova and Pulse – gain 40,000 customers.

The smaller retailers also grew, although most are still very small. But their entry in the market brings further competition, often through new ways of serving customers. No one knows how they will fare, but neither do the large retailers.

The entry of eight new retailers in the last eighteen months – four of them intending to actively pursue household consumers – brings the total number of retail brands to 27.

As well as the pricing trends for 2014 I spoke about earlier, I think you can also clearly see this competitive pressure in the announcements over the last few weeks from the ‘big 4’ retailers about their pricing plans for 2015.

Across the country, our estimates suggest that we should see an average change in residential prices for the year ending June 2015 of zero or negative.

Of course, some regions will see prices rise and some will see them fall due to changes in charges for local networks. But overall we should observe zero or negative price changes as the distribution charges regulated by the Commerce Commission are declining on average by 1.1 percent.

I would like to now turn my attention to 2015 and beyond.

I'm sure you'll all know that when the Electricity Authority was founded our statutory objective had three distinct areas of focus – competition, reliability and efficiency.

Initially we focused on reliability. There has been good progress in this area, as generator management of dry years illustrates.

Of course, we need to remain vigilant and – with the Security and Reliability Council – continue to proactively investigate any areas of potential weakness in the electricity system.

As I'm sure you know the Minister of Energy and Resources requested the Authority undertake an inquiry into the Penrose outage.

We are receiving good cooperation from Vector and Transpower in our review, and we will be seeking the Security and Reliability Council's wise advice on any issues we uncover or any judgements we might have to make.

The Authority's clear focus in the last couple of years has been on our programme of work to improve retail competition.

The What's My Number campaign remains a flagship programme and we are rapidly working through our project to make it easier for consumers to access and use retail data.

My fellow Board members and I will be considering the next part of our retail data project over the coming months.

Many of our other activities have contributed towards promoting competition for the long-term benefit of consumers. We still have work to complete in the competition area, but much has been achieved.

So, it's logical that we are now turning our attention to the third limb of this statutory objective, the area of the efficient operation of the electricity industry, and in particular efficient pricing.

The number of small scale solar installations – those with less than 10kW capacity – jumped from around 1,900 in our registry in December 2013 to almost 4,500 in December 2014. In other words, the number of new installations in 2014 more than doubled the total amount of small scale solar in the system.

We're starting to see solar being marketed hard in NZ. It's important we don't make the same mistake as other jurisdictions where perverse price signals, often driven by environmental objectives, and investment decisions in response to them are now creating long-term issues.

We need to make sure consumers considering a move to an alternative generation source face prices that reflect the costs they impose on the system so they make their investment decisions with good information.

One result of the increased uptake of solar is obviously the effect on distribution pricing.

If current trends continue, we will see more and more affluent New Zealanders reducing their off-take from local networks, leaving a smaller pool of New Zealanders less able to afford to pay for solar panels covering an increased share of the cost of the distribution networks.

Although it is very early days in regard to small scale solar, it is obvious the current structure of distribution charges in many areas does not fit with the Authority's statutory objective relating to the efficient operation

of the electricity industry. We were pleased to receive communications from the Electricity Networks Association in December last year that indicated they held a similar view and that they're proceeding to work on the issue.

In addition to ENA's work, the Authority is progressing a review of distribution pricing focussing on issues like the signals given to distributed generators, electric vehicles, battery technology and so forth.

Our work on reviewing the transmission pricing methodology is also progressing, with an options working paper to be released in early April.

We have also been following up on a recommendation from the Wholesale Advisory Group to consider how the spot market's efficiency might be improved. We have been considering various adjustments, such as basing settlement on real time prices and introducing a period ahead market. This is important as more consumers start using the information that is available through their smart meters to make

decisions. We will put a discussion paper on these matters out for consultation very soon.

Consumers need to have confidence when they respond to spot prices that those prices are real – the actual prices they will be charged.

In addition, consumers need to be made aware of the risks they face from “going on spot” and it needs to be clearly demonstrated they knew the risks they were taking.

To some extent the risks could be mitigated if consumers on spot prices were offered a retail cap product. This in turn would be facilitated by retailers having ready access to a cap product in the futures market.

Our Retail Advisory Group is making substantial progress in assessing the market impacts of the low fixed charge regulations. We have the power under s16 of the Electricity Industry Act to do this review, but it falls to other parties to decide whether to review the regulations.

Finally, a development I’m particularly interested in, and see great potential for in the somewhat unique New Zealand context, is electric vehicles.

With 80% of New Zealand's electricity now from renewable sources, a figure that is likely to grow, electric vehicles could reduce emissions.

Making it easy for consumers to access spot prices has the potential to boost the commercial case for electric vehicles. NZ's spot electricity prices typically have high diurnal variation due to our largely 'run of river' hydro system. Prices in the middle of the night are generally considerably lower than during the day when consumption of electricity is high, making night-time charging of electric vehicles at a low cost to the consumer and the economy a realistic prospect.

Thank you for attending tonight's event and for contributing to a very successful 2014. We look forward to working with you in 2015, so please join us for refreshments, and further conversation.

The rest of the members of our Board and the Authority Chief Executive and Senior Leadership Team are also here tonight, and many of us will be at Downstream Conference over the next two days.