

## **Chief Executive's Speaking Notes for 17 November Breakfast Function**

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### **Intro**

Thanks Brent and thanks to all of you for getting up early to attend our first breakfast function. I know many of you have travelled a long way to be here. I guess the way I see it, we're on a journey to improve market performance and increase consumer & investor confidence in the sector.

We have been on this journey for some time but now we're driving a new model vehicle with a new engine, a stronger chassis and suspension to handle bumps and sharp bends in the road and new drivers have been introduced. The body looks the same, but it sports a new suite of colours.

We've arrived at our car show this morning. We're keen for punters to look under the bonnet and under the chassis to get a feel for the vehicles' likely performance and to see whether it really can last the distance.

So I'll just show you around a little – point out some key features and interfaces between the foundation documents and then open the floor to questions.

### **Overall**

The Authority has inherited a demanding work programme from the Commission particularly regarding: consumer compensation, scarcity pricing, locational pricing risk, demand-side response, and more standardised tariffs and use of system agreements. Each of these items are focused on improving market performance in the key areas of strengthening competition and encouraging more efficient decisions about security of supply.

We're proceeding with that work in a judicious manner and will be assessing them in terms of their contribution to furthering the Authority's statutory objective. In addition to keeping the work programme moving forward, we have been giving considerable thought to the Authority's decision-making arrangements, stakeholder engagement and organisational matters.

### **Decision-making**

#### **Statement of Intent (SOI)**

The Authority has been thinking about what outcomes it wants to pursue over the next 3 – 5 years. We've made a start on this in the inaugural SOI which should be tabled in Parliament shortly. Without going into the details, our outcome indicators are centred around competition, reliability and efficiency, and the need to build confidence and understanding about the sector's performance in regard to them.

#### **Interpretation**

We've also been thinking about our statutory objective, which is:

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

So, what do we mean by competition? In what ways does competition benefit consumers? And what does it mean to *promote competition for the long-term benefit of consumers*? The same kinds of questions arise in regard to reliable supply and operational efficiency. We believe it is essential

to provide clarity to interested parties about what we mean when we discuss these terms and when we make decisions using them. We're keen on getting feedback from a wide cross-section of interested parties before we 'lock them down'.

### **Code amendment principles (CAPs)**

The Authority has also given considerable thought to the decision-making principles it should adhere to when making Code amendment decisions, called the Code amendment principles or CAPs.

The CAPs were inspired by the guiding principles adopted under NZEM and MARIA, but the guiding principles presented core economic precepts, such as supply equals demand.

We felt we needed principles that would provide greater assistance for regulatory decision-making and ones that assisted interested parties to predict regulatory decisions, particularly to predict the likely scope of the Code and investment decisions.

The obvious regulatory approach is to require clear and compelling problem identification (market or regulatory failure) and subject all decisions to quantitative cost-benefit assessment (CBA).

But CBAs are often not conclusive about which options are the best, so we've proposed tie-breaker principles to guide decision-making in those cases:

- Preference for small scale 'trial and error' options – flexible, scalable, reversible
- Preference for options that bring stronger competition
- Preference for market-oriented solutions
- Preference for Opt-out features
- Preference for non-prescriptive options

And CBAs are not always conclusive about whether options have positive or negative net benefits. What do we do when there are no small scale, flexible, scalable, and easily reversible options? We are proposing under the CAPs to consider the risk of making and not making Code amendments.

So, our Interpretation is a discussion of what the Authority's statutory objective means, which is relevant for all Authority decision-making (e.g. exemptions etc), and the CAPs present the principles guiding our decision-making on Code amendments.

## **Stakeholder Engagement**

We see effective stakeholder engagement as a key priority for the Authority and that was one of five key governance issues the Ministerial Review pinpointed for improvement. The Ministerial Review gave specific directions to have advisory groups make recommendations to the Authority Board.

### **Advisory Groups (AGs)**

The AG scheme we've put together needs top-notch input from you to make it a success. The AGs can do a heck of a lot and can really be the turbo-charger for us. If you can jump on board with that and bring the kind of skills and the kind of attitude to it that I'm hoping and believe you will, then I think that will go a long way to bringing a sea-change in the way that we do things. We will also need strong leadership from Advisory Group chairs.

In our proposed scheme AGs address commercial, regulatory and strategic considerations, and their core role is to reconcile alternative views in ways that promote the long-term benefit of

consumers and satisfy the CAPs. The Board is the ultimate decision-maker but we want AGs to take ownership of the solution process and we want them to present compelling recommendations to the Board.

We're proposing AGs have responsibility for deciding the content of discussion documents, for holding workshops with interested parties and for bringing solutions to the Board. I'm personally very excited about getting the new structures in place, but we do need to carefully transition to them.

It is absolutely essential we avoid disrupting the work programme, especially the 7 priorities in section 42 of the Act. It is essential Advisory Group members build a constructive relationship with Authority staff and that everyone understands not only their role but also the role played by others. In addition to AGs, with their commercial/regulatory/strategic focus, Working Groups will be established to provide technical and specialist input to AGs.

I think we're potentially in that happy place where we can get 'the best of both worlds' because we have a statutory structure to deal with public policy issues and an AG charter to bring stakeholders more directly into decision-making. But at the end of the day, if the problems are just too hard to resolve through AGs, the Board can use other parties e.g. staff or independent experts or 'expert groups' to bring solutions and recommendations to the Board.

### **Consultation Charter**

As shown on the slide, the consultation charter covers the CAPs and the central role AGs have in the Code development process.

### **Security and Reliability Council (SRC)**

The role and purpose of the SRC is specified in the Act. We see it as having a strategic advisory role to the Authority, rather than duplicating the day-to-day overview of the electricity system and the System Operator.

We're really looking to bring in the wisdom and expertise of senior consumer and industry personnel and we've made a commitment to that by having the Authority's Chief Executive as its principal representative to the SRC.

We are also intending to appoint members for 3 years (c.f. 2 years for other AGs) and have the SRC meet with the Board annually. In terms of timing, we're intending to finalise the SRC charter and terms of references before Christmas and then call for Nominations as soon as possible after that – may be in early 2011.

### **Service Providers**

As you'll see with the new organisational structure for the Authority, we recognise the fundamental role Service Providers play in every aspect of the market and none more so than the System Operator.

My bet is that Service Providers are probably feeling neglected by now but the focus till now has been on setting up the Authority and getting the foundation documents out for feedback. However, I want to emphasise that I'm very keen to establish productive and harmonious relationships with all service providers going forward.

## Organisation

### New functions

Brent has pretty much covered this topic, all I can add is that we want to get some early traction with the new functions:

In regard to the consumer switching fund (CSF), we're well advanced on identifying the best value use of those funds. The Electricity Commission initiated considerable work prior to 1 November, developing a strategy and we are currently finalising our review of real and perceived barriers to switching and we're expecting to be tendering for programs to encourage switching this side of Christmas or in the first quarter of 2011.

We are also well advanced on developing the Authority's new market monitoring function, and we will be issuing an information paper early next year to seek stakeholder views on our approach.

### New skills and new structure

We've already completed a review of the organisational structure inherited from the Commission, which will take effect in early 2011. We've decided we needed to bring in more regulatory economics expertise into the organisation, stronger contract management capability and co-locate transmission and security of supply policy roles with other policy development roles in the organisation.

Rather than balloon out to 8 direct reports, we've collapsed the structure to 5 core areas:

1. *Corporate* - this team will lead our internal governance and also our accountability interaction with the Government;
2. *Legal & Compliance* – this team will take the lead on internal legal matters and lead our compliance interaction with market participants;
3. *Operations Development* – this team will take the lead on the highly technical aspects of developing the Code and lead our interaction with service providers;
4. *Market Design* – this team will take the lead on public policy oriented Code development and lead our interaction with AGs; and
5. *Market Performance* – this team will undertake our new market monitoring function, quantitative analysis of Code options, and develop and manage our data bases.

I want to finish by touching briefly on Vision.

### Vision and values

Our vision is to be recognised as a world-class electricity regulator. We need to aim for world class level because New Zealand is small and distant from most of the world's population centres. We can't import electricity, and it is pretty expensive to import fuel, and yet we have one of the most challenging electricity systems to govern in the world.

We have to be rally on top of our game if we're going to deliver the best outcomes for our export sector. The exporters are the ones that go out there and compete with the rest of the world and if we're not top class we're really putting hurdles in the way of them.

## Conclusions

So, to wrap up, our aim is to bring greater regulatory certainty and predictability. We've got to last the distance this time, which means we have to build governance arrangements that are sustainable over the long-term and that evolve as we undertake the journey. We need to have far greater stakeholder 'buy in' to the decision-making process so that when decisions don't go your way, you'll stay inside the tent and we've got to bring all that together to achieve the productivity gains that New Zealand sorely needs to lift our living standards.

So, I invite you to work with us on our journey to lift market performance and bring real gains for New Zealand.

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