



Office of Hon Gerry Brownlee

MP for Ilam

Minister for Economic Development

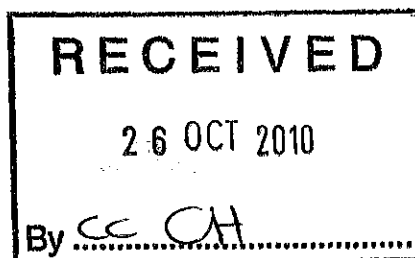
Minister of Energy and Resources

Leader of the House

Associate Minister for the Rugby World Cup

26 October 2010

Dr Brent Layton
Chair
Electricity Authority
PO Box 10041
WELLINGTON 6143



Dear Brent

ANNUAL LETTER OF EXPECTATIONS

I am writing to you to convey my expectations for the Electricity Authority for 2010/11. This letter is intended to aid the Authority's direction, and is an integral part of the accountability framework as prescribed by the Crown Entities Act 2004. As responsible Minister I am accountable to the House of Representatives for your performance. This letter complements the enduring letter of expectations the Minister of Finance and the Minister of State Services sent to statutory Crown entity Chairs on 22 December 2008, a copy of which is attached as Appendix 1 for your reference. I expect the Authority to act in accordance with the expectations set out in that letter as well as this letter.

Priorities for the Electricity Authority

In December 2009, following a Ministerial Review of the electricity market, Cabinet made a number of decisions on measures to improve the performance and governance of the electricity industry. The Electricity Authority has been established as part of these changes to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

The reform measures will increase the independence of electricity sector regulation, and provide more clarity around functions of the various industry bodies. These changes are expected to encourage greater stakeholder involvement in rule-making; facilitate more timely improvements to the market; and improve regulatory and investment certainty.

A summary of the decisions arising from the review in relation to improving competition and pricing in the electricity market, and in relation to security of supply, is attached as Appendix 2. The Electricity Commission made considerable progress with many of these matters, but there is still much to do. I expect these actions to be a significant focus of your initial work programme. A number of these matters are specified in section 42 of the Electricity Industry

Act¹, and must be reported on within the next year. There are also matters in section 42 that are not listed in Appendix 2, such as the Authority's involvement in facilitating or providing an active market for trading financial hedge contracts, and provisions relating to distributors' liabilities under the Consumer Guarantees Act 1993. I expect these to also form part of your initial work programme.

I look forward to hearing from you on these matters over the next 12 months, and thank you in advance for your assistance in putting these reforms in place.

Financial management

In line with the current fiscal context I also expect the Authority to:

- have financial sustainability as a critical part of its strategy;
- demonstrate a strong understanding of the business e.g. price, quality and standards of the service, the cost drivers and how the board will manage them;
- set tight, realistic budgets and manage within those budgets;
- have realistic pay and employment conditions; and
- consider how the Authority's services can be delivered better and more cost-effectively, including looking at opportunities to use technology or shared services agreements to lower costs and improve services, and implement changes to deliver on your findings.

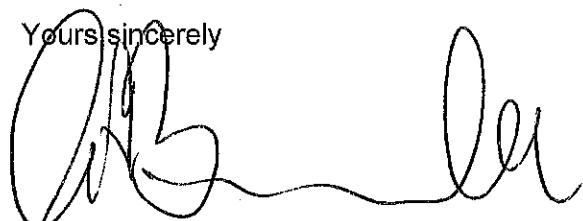
Engagement with Government

You will note that section 18 of the Electricity Industry Act provides that I may, from time to time, request that the Authority look into a specific matter relating to the electricity industry. I would also expect that the Authority will contact me if it considers there is an issue relating to the electricity industry that should be brought to my attention.

I expect you to maintain the "no surprises" policy and to inform me well in advance of any material or significant events, transactions, and other issues that could be considered contentious or attract wide public interest, whether positive or negative.

In undertaking your governance role I expect the Authority to work constructively with my monitoring department, the Ministry of Economic Development, in accordance with the Output Agreement.

Yours sincerely



Hon Gerry Brownlee
Minister of Energy and Resources

¹ Statements in the appendix may be phrased differently from the text in section 42.

APPENDIX ONE: CROWN ENTITIES ENDURING LETTER OF EXPECTATIONS



Office of Hon Bill English

Deputy Prime Minister
Minister of Finance
Minister for Infrastructure

22 December 2008

Dear statutory Crown entity Chairs,

Enduring Letter of Expectations

This letter replaces the previous letter of expectations that was sent on 17 December 2004 to the chairs of boards of statutory Crown entities and Crown companies.

Ensuring value for money for New Zealanders

A more focused, efficient and productive state sector that delivers services differently and more cost effectively will require all of the state services to focus on improving the performance of every taxpayer's dollar spent.

We expect that each Crown entity board:

- keep under review the Crown entity's expenditure;
- identify particular expenditure or programmes that are not effective or providing good value for money; and
- act on those findings.

Demonstrating performance

Informative and accurate financial and non-financial performance information will enable Crown entities to demonstrate value for money. High quality performance information also enables Ministers to make more informed decisions.

We expect that Crown entities will have a performance measurement framework that is reviewed and updated regularly. For further information refer to <http://www.ssc.govt.nz/performance-measurement>.

Engagement with Ministers and monitoring Departments

Crown entities are expected to work with their Ministers on a "no surprises" basis, so that Ministers are informed at the earliest possible stage of: matters that may be controversial or cause public comment, major strategic initiatives, and implications that decisions may have elsewhere in government.

Crown entities and monitoring departments are expected to work together professionally and constructively, and share information in a timely manner. This will be particularly important as we will be seeking ongoing assurance from both Crown entities and monitoring departments about what each Crown entity is doing about ensuring value for money

Further expectations

We expect that Crown entities will:

- Provide the Treasury and monitoring departments with accurate financial information within stated timeframes;
- Maintain standards of integrity and conduct as set out in the code of conduct for the state services www.ssc.govt.nz/code-guidance-stateservants;
- Contribute to achieving a world class professional State services through the development goals framework; <http://www.ssc.govt.nz/development-goals>;
- Comply with the equal employment opportunities provisions as set out in the Crown Entities Act.

Yours sincerely



Hon Bill English
Minister of Finance



Hon Tony Ryall
Minister of State Services

APPENDIX TWO: SUMMARY OF ACTIONS IDENTIFIED IN THE ELECTRICITY MARKET REVIEW (RELATING TO THE ELECTRICITY AUTHORITY)

Measures to improve competition and pricing

The Government decided to implement a number of measures to improve competition and pricing in the electricity market, in particular:

- Requiring lines businesses to put in place more standardised lines tariff structures and use-of-system business rules to facilitate retail competition;
- Introducing, as a matter of priority, a transmission hedging mechanism to assist retailers to manage energy price risks created by transmission constraints and losses;
- Facilitating more demand-side participation in the wholesale market through measures such as more accurate forecasting of spot prices, setting spot prices in real-time (not ex-post) and enabling demand response to be despatched in the same way as generation. The Electricity Commission consulted on 'dispatchable demand' earlier this year. Following analysis of the results of the consultation, I expect that the Authority will pick up this action and develop rules for facilitating more demand-side participation;
- Public release, free of charge or with a nominal charge, of all wholesale market bids and offers the following day (instead of two weeks later). The Electricity Commission has completed this action, with a rule providing for the next-day publication of bids and offers;
- Undertaking monitoring and analysis of disclosed wholesale market data to assist with rule development;
- Ensuring that guidelines and standards for smart meters provide for (or allow upgrades for) energy efficiency capability, open access communications, customer switching and the development of smart networks;
- Encouraging retailers to make tariffs available, as an option for consumers, that provide incentives to better manage electricity consumption including through shifting load to off-peak times and conservation during dry years;
- Shortening the timeframe for switching between retailers from the current maximum of 23 business days to, say, 75 percent within 3 business days and 100 percent within 10 business days. This objective has been significantly progressed by the Electricity Commission. From 1 October 2010, 75% of switches must be processed within 10 business days, and half of all switches within 5 business days. I expect the Authority to review switching times again next year to see if the switching period can be further reduced;
- Facilitating and promoting to consumers the benefits of increased switching of electricity suppliers;
- Developing mandatory terms and conditions (including pricing guidelines and principles) for purchase by retailers of power from small-scale distributed generation (to reduce transaction costs for individual investors in small-scale distributed generation);

Measures relating to security of supply

The Government has also decided on several measures to improve security of supply in the electricity market, in particular:

- Requiring retailers to make payments to consumers in the event of a conservation campaign or dry-year power cuts;
- Putting a floor on spot prices during a conservation campaign or dry-year power cuts;
- Requiring all generators above a certain size, including SOEs and listed and privately-owned companies, to disclose information (such as hydro reserves, fuel stockpiles and availability, planned outages and net hedge positions) which informs the marketplace on supply risks and management of risks.