

19 May 2023

Hon Dr Megan Woods
Minister of Energy and Resources
Private Bag 18041
Parliament Buildings
Wellington 6160

Dear Minister

ANNUAL LETTER OF EXPECTATIONS FOR 2023/24

Thank for your letter of 6 April 2023 conveying your, and the Government's, strategic and performance expectations for the Electricity Authority Te Mana Hiko (the Authority) in relation to the 2023/24 financial year and beyond.

The Authority promotes competition in, reliable supply by and efficient operation of New Zealand's electricity industry for the long-term benefit of consumers. As kaitiaki of electricity in Aotearoa, we develop, set and enforce rules for the industry to follow, and monitor compliance with those rules and performance in the relevant markets.

A recent amendment to the Electricity Industry Act 2010 has created an additional objective for the Authority: to protect the interests of domestic and small business consumers in relation to the supply of electricity to them. This objective applies to the Authority's activities in relation to dealings industry participants have with domestic and small business consumers. We are working through the implementation of the additional objective across all our work while progressing known areas of priority that will give effect to the objective, for example a review of the Consumer Care Guidelines.

The electrification of the New Zealand economy is central to our progress towards a net zero carbon future. The Authority has a critical role to play to support the decarbonisation of the electricity industry, and in doing so support the decarbonisation of other industries. The Authority appreciates the scale of this challenge, and to ensure that the electricity sector is competitive, reliable and efficient for the long-term benefit of consumers.

The Authority has a range of projects underway or planned that will support the electricity sector to evolve throughout the transition. For example, the Authority's Future Security and Resilience work programme will help New Zealand's power system remain stable, secure and resilient as it evolves over the coming decades. This work includes considering the issues and opportunities with the current arrangements for system operation that must be managed during the transition.

The Authority also looks forward to supporting and contributing to the Government's Energy Strategy. The Authority has an energy transition roadmap in place to ensure our key priorities are aligned to the Government's expectations, particularly those outlined in the Emissions Reduction

Plan. The roadmap will be updated as our research and industry discussions inform our current and emerging priorities.

The Authority is also aware that unexpected challenges (such as the devastation of cyclone Gabrielle) can occur and will require a system response, so preparedness and anticipation are critical to ensure the system adapts and the lights stay on.

Significant measures have been taken to avoid potential outages during winter 2023, and some additional, longer-term interventions will be progressed this year to make the system more resilient during the transition and to extreme weather events.

We continue to engage actively with the Ministry of Business, Innovation and Employment (MBIE), the Energy Efficiency and Conservation Authority, the Commerce Commission, and the Gas Industry Company (including through the Council of Energy Regulators), along with other relevant agencies such as the Climate Change Commission and the Infrastructure Commission, on key priorities of mutual interest and to inform and support an energy regulatory system that enables innovation, competition and consumer choice.

Overall, the Authority is working hard to prepare for the transition and deliver several critical programmes of work. We acknowledge the pace and extent of change requires us to work more quickly and better with industry and other government agencies on current and emerging issues. This underpins our request for increased funding and the need to scale up to support the transition, at least cost to consumers.

Section 44B backstop regulation power

As requested, the Authority will publish a report before 1 September 2023, to assist your consideration of the backstop regulation power in section 44B of the Electricity Industry Act 2010. This report will explain, for each of the matters specified in section 44B(2), how the Electricity Industry Participation Code 2010 (the Code) addresses the matter and how it will further the Authority's statutory objectives.

The Authority has made significant progress towards the section 44B(2) matters that emerged as recommendations from the Electricity Price Review. For example:

- the Code was amended in 2020 to prohibit retailer saves and win-backs for 180 days after a consumer switches
- work to support New Zealanders in understanding the benefits of comparing and switching retailers continues, and we will soon consult on improving and consolidating the mandatory data collected from retailers to enable consumers to make the right decision for their electricity needs. We are also considering several options on how to improve the support that Powerswitch currently provides to consumers to help them decide whether to switch retailers
- in relation to requirements for distributors to offer retailers standard terms for access to their networks, the Code was amended in 2020 to require distributors to develop and offer a Default Distributor Agreement (DDA), and by 2021 all distributors had done so. We will continue to update the standard DDA so it better balances the interests of both parties
- in terms of the requirements for the gentailers to disclose their retail profitability, they have disclosed their internal transfer prices and the methods used to calculate them, and the Authority has published these, along with some benchmarks. Retailers have also disclosed their retail gross margin data to the Authority, and the Authority will be publishing that data soon.

Market confidence and security of supply

Regarding the 9 August 2021 event, as we have reported to you the Authority has completed the immediate recommendations due for implementation ahead of winter 2023 and the longer-term policy actions are progressing. We provided a briefing recently (31 March) which outlined progress on those longer-term actions, including the Authority's Market Design Advisory Group (MDAG) report, which is due to be published soon.

Transpower held a pan-industry exercise last year, implemented the recommendations from the Authority's phase 1 review, and is now progressing various other recommendations from the reports it commissioned.

The Authority is working with the system operator to ensure that the next industry exercise (happening this month) encompasses distributor-to-retailer and retailer-to-consumer communications. This will test whether consumers, especially medically dependent consumers, receive the information they need should a demand management event occur in the future.

The Authority's *driving efficient solutions to promote consumer interests through winter 2023* consultation identified four market signals that could improve information and incentives, and these are being implemented ahead of winter 2023:

- provide better information on headroom in the supply stack
- provide forecast spot prices under demand sensitivity cases
- system operator review of wind offers based on external forecasts; and
- clarify availability and use of 'discretionary demand' control (such as ripple control).

There are five other market enhancements that the Authority will either progress or investigate for progression ahead of winter 2024 and 2025.

Monitoring the wholesale market and focusing on compliance

The Authority has increased its monitoring of the market since the new trading conduct Code provisions came into force. This involves analysing spot market data, identifying trading periods where the prices are not immediately explainable, and doing in-depth analysis until staff are satisfied or have enough evidence to refer cases to our compliance team. All this analysis is published weekly on our website.

The Authority has advanced the implementation of its Risk Framework. The Risk Framework guides which areas of the Code the Authority will undertake proactive compliance interventions into. As part of its Compliance Strategy the Authority is expanding its compliance education campaign to drive increased voluntary compliance and greater trust and confidence in the industry. We have worked hard on increasing timeliness of resolution and have significantly reduced the backlog of open compliance cases through improved practices and increased resources.

Supporting the growth of renewable generation, firming capacity and demand-side participation

The Authority is developing trading in New Zealand electricity futures and options on the Australian Securities Exchange through an enduring market-making approach that should improve efficiency, trust and confidence in the market. Following the implementation of a commercial market-making scheme in September 2022, we are preparing to assess the current scheme against initial objectives and to ensure it remains fit for purpose.

The Authority is reviewing the market for financial transmission rights to ensure that the current market settings and funding are appropriate and benefit consumers. Financial transmission rights help market participants manage their locational price risk (LPR), which will be increasingly important in the transition to a 100% renewable electricity system. The increasing share of intermittent generation is likely to see increasing spot price volatility and increasing LPR for market participants. It is important to ensure that the market settings will reflect this changing environment, enabling firms to manage LPR better, and thereby enabling the greatest benefit to consumers.

The Authority intends to take action to improve the information disclosure obligations set out in the Code to reduce information asymmetry in the wholesale market and increase competition. The Authority will consult on options and potential draft Code amendments.

One of the issues identified as part of the various reviews into the events of 9 August 2021 was a focus on the role of intermittent generation. The output of renewable resources varies as production is dependent on factors such as wind speed and cloud cover. The increase in variable generation expected with the growth of renewables needs actionable and accurate pricing.

Actions from our review of the forecasting provisions for intermittent generators will:

- help electricity generators with firming capacity decide when to make their resources available
- support demand-side participation as it will assist demand-side participants with decisions to reduce their consumption in times of short supply/high demand; and
- support the continued growth of renewable generation through greater trust and confidence in price signals.

Regulatory settings for the distribution sector

Distribution networks have a critical role to play in the transition to a low-emissions economy, connecting electricity users with electricity producers. The electrification of transport and process heat will drastically increase the amount of electricity passing through these networks.

The Authority continues its work on updating the regulatory settings for the distribution sector, to support the transition whilst focusing on competition, reliability and efficiency of the distribution network for the long-term benefit of consumers. Workstreams that the Authority will progress in 2023/24 include:

- increasing data flows and improving access to smart meters to enable parties to make informed decisions about their risks and opportunities across the system, mainly on the low-voltage network
- creating an environment where non-network solutions (flexibility services) can replace network upgrades wherever possible, to ensure that distribution network capacity grows at the lowest economic cost to consumers; and
- supporting the development and growth of flexibility services, especially those supplied by independent parties, such as flexibility traders.

Connection charges and regulatory barriers for public electric vehicle (EV) chargers

The Authority remains committed to promoting the ongoing reform of distribution pricing. More efficient pricing will contribute to better investment in and use of distribution networks, provide appropriate signals to consumers as they consider investing in their own distributed energy resources, and help the transition to a low-emissions economy to be on the most efficient path – so consumers pay less and/or get better value for money.

Connection charges are a key component of distribution pricing. The Authority will investigate the variation in distribution connection charging approaches for load customers, including public EV chargers, and develop potential options to address any identified issues. The Authority will then consider amending the Code to address any issues that are within the Authority's ambit, consult on these in late 2023, and likely make decisions on implementing these changes in the first half of 2024. We are exploring ways to progress this work more quickly while avoiding unintended consequences.

The Authority will investigate whether there are other regulatory barriers to the roll-out and adoption of EV technology as part of its work on updating the regulatory settings for distribution networks.

Protecting the interests of domestic and small business consumers

As mentioned, the Authority now has an additional objective, to protect the interests of domestic and small business consumers in relation to the supply of electricity to those consumers. Our work around the Consumer Care Guidelines (the Guidelines) in the 2023/24 year will be a key plank of delivering on the additional objective.

Authority staff have reviewed retailers' self-assessments of their alignment with the Guidelines, conducted an operational review of the Guidelines, and reviewed them for consistency with the additional objective.

The Authority is considering its next steps. Making the Guidelines mandatory is one of several options that Authority staff will consider, by way of presenting an options paper to the Board, followed by a consultation paper later in the year.

Monitoring retailers' conduct, and supporting broader sector initiatives

Work will continue to improve the collection of retail market data, to facilitate the monitoring of competitiveness and consumer protection in the retail sector. This includes monitoring the conduct of retailers towards vulnerable consumers and in relation to prompt payment discounts and late payment fees.

The Authority will support sector initiatives by the Consumer Advocacy Council (the Council), the Energy Hardship Expert Panel, and the Energy Hardship Reference Group. The Authority participated in the Energy Hardship Reference Group's workshops and provided feedback to the Panel's report prior to its release for consultation.

In support of wider sector initiatives, the Authority staff will continue holding regular meetings with the Council to share information and updates on key issues and relevant areas of work. The Authority and the Council are formalising this working relationship with a Memorandum of Understanding.

Preparation of accountability documents

In accordance with our obligations under the Crown Entities Act 2004, we provided the draft Statement of Performance Expectations 2023/24 and Statement of Intent 2021-2025 Amendment for your consideration on Monday 24 April 2023. Thank you for your feedback on the draft documents, which we received on 17 May. Authority staff will work with your officials to address your comments before the documents are finalised.

Final versions of both documents will be provided to you for tabling in the House of Representatives in June 2023.

General governance and reporting expectations

The Authority is making an ongoing effort to meet the requirements set out in the enduring letter of expectations, including general governance expectations. We remain proactive in our engagement with MBIE as our monitoring agency. This helps to ensure we are meeting the expectations outlined in the *Monitoring arrangements for MBIE-monitored Crown entities*, in line with our enduring output agreement. We will continue to provide four-monthly reports on the Authority's progress as soon as practicable after the end of each reporting period.

We have signalled our resource pressures and are currently undergoing a baseline review. The transformation of the electricity industry and the critical role electrification must play in the Government's broader climate change goals requires us to work on expansive work programmes to discharge our statutory objectives and ensure the transition to a low emissions future is at least cost to consumers. We must keep pace with the change underway to enable transformation through regulation that is fit for purpose.

We must also raise our capacity and capability to meet the expectations of a modern regulator. Purposeful engagement across industry, agencies and consumers is critical for informed decision making that results in improved consumer outcomes. We also need to progress our commitment to Māori Crown relations and further develop our organisation's cultural competence and capability. The Authority acknowledges the importance of improving engagement with Māori and progressing our understanding of te ao Māori, te reo Māori and te Tiriti o Waitangi. We are committed to developing this critical aspect of our organisation and our role in the industry. Genuine commitment requires an organisation-wide commitment driven by the right advice and support. The Authority acknowledges it needs to resource appropriately for this.

The Strategic Baseline Review

We will provide advice to you on the findings of the Strategic Baseline Review. The outcomes of this review will support and enable us to deliver on the important work and expectations outlined in this letter. The Authority continues to work with MBIE on the Strategic Baseline Review and will implement any recommendations as appropriate.

Board self-evaluation

The Authority Board is committed to regular self-evaluation, and it is a specific item in the Board's annual work plan. The Authority Board also regularly schedules Board-only time in its meetings to facilitate this. We will continue to provide you and MBIE with the results of the Board's self-evaluation.

Concluding remarks

We will engage proactively with you and your office around emerging issues, including when we receive substantive media enquiries. We intend to maintain this constructive engagement with you.

Yours sincerely



Dr Nicki Crauford
Chair
Electricity Authority