

5 April 2022

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

Dear Minister

ANNUAL LETTER OF EXPECTATIONS FOR 2022/23

Thank for your letter of 23 March 2022 conveying your and the Government's strategic and performance expectations for the Electricity Authority (the Authority) in relation to the 2022/23 financial year and beyond.

The Authority plays a critical role for all New Zealanders. We oversee the operation of the electricity system and markets, developing, setting and enforcing the rules the market must follow and holding industry to account by actively monitoring the market's behaviour and performance.

The Authority's purpose is to enhance New Zealanders' lives, prosperity and environment through electricity. The breadth of our purpose reflects the broader social and economic framework in which we operate. As kaitiaki of electricity, we steward the electricity system on behalf of all New Zealanders.

Stewardship of the sector is even more crucial as we steer through the next few years. Mass electrification, retirement of thermal generation, a volatile climate and a pandemic puts an unprecedented level of pressure on the system. There will be more challenges during the next few years which will require an all of system response — preparedness and clarity of expectations are critical. The Authority has a core role to ensure the system adapts and the lights stay on.

We note the Government's focus, to be reflected in the forthcoming energy strategy, is a just transition to net zero carbon emissions by 2050, while building a more productive, sustainable and inclusive economy, and that the Government is developing the first Emissions Reduction Plan to meet the first emissions budget for 2022 to 2025.

The Authority is well-placed to align with the Government's priorities. We recently published our Energy Transition Roadmap, which sets out how the Authority will work to ensure the transition to low emissions energy is as efficient as possible while maintaining energy security, system adaptability, and affordable electricity for consumers.

Energy sector strategic planning

The work set out in the Energy Transition Roadmap provides the basis for the Authority's support for the first Emissions Reduction Plan and development of the Energy Strategy. As we indicated in the cover paper, the Roadmap is a living document, which we will update at regular intervals, including as necessary to further support the Emissions Reduction Plan and Energy Strategy. We intend to develop the next level of detail on this plan and will form a view on the required capability needs of the Authority to give effect to the changes in the sector.

As well as the Roadmap, the Authority will collaborate with other parties to support development and delivery of the Emissions Reduction Plan and Energy Strategy. In particular, the Authority would welcome and encourage early and close engagement of the Council of Energy Regulators on the Energy Strategy.

Confidence in the market

As kaitiaki of the electricity sector, the Authority is focused on building and maintaining trust and confidence in the electricity market and in the wider system. This involves ensuring the market is responding to short, medium and long-term challenges such as dry years, fuel shortages and major outages, enabling new technology and innovation, as well as increased investment in renewables.

A proactive monitoring and compliance function is also critical to maintaining and building trust and confidence. The Authority has strengthened its monitoring and compliance capability, and is developing a new compliance strategy, which we will look to leverage to promote outcomes for consumers consistent with our statutory objective in 2022/23. This strengthened capability will support the Authority to keep you informed of electricity market issues and industry compliance issues as they arise and our actions, as appropriate, to resolve or manage them.

The compliance strategy emphasises education to ensure participants are well informed of what compliance expectations are, supported by timely and robust enforcement action in the event they fail to comply.

A particular area of focus will be continued monitoring and enforcement of the trading conduct provisions introduced in 2021. For these provisions to be effective, it is important that sanctions hold parties that breach the provisions accountable and promote a culture of compliance throughout the industry. We have been working with the Ministry of Business, Innovation and Employment to improve the penalties regime through the Electricity Industry Amendment Bill. We welcome the proposed changes to the penalties, which will assist in promoting effective compliance with the Code.

The Authority continues to work with Transpower in response to 9 August 2021 power cuts and subsequent reviews and recommendations. The Authority's Phase 1 report identified immediate actions necessary including improved communication protocols and an alternative to Transpower's load shed and restore tool. Good progress has been made on these key areas and the Authority will continue to actively monitor Transpower's response to the full suite of recommendations in the Phase 1 report.

The Authority has also published a preliminary decision that the events of 9 August 2021 did not constitute an Undesirable Trading Situation. Consultation for this preliminary decision closed on 3 February 2022. Phase 2 of the Authority's review of 9 August 2021 under section 16 of the Electricity Industry Act 2010 is underway and seeks to assess any final matters that have not been already covered by other reviews.

The Authority is also working with Transpower on the recommendations of MBIE's report "Investigation into electricity supply interruptions of 9 August 2021". The Authority's critical focus is on ensuring a reliable electricity supply ahead of winter 2022. We have prioritised our response to focus on the most important and tangible areas for the whole system, with our immediate attention on those recommendations that help mitigate dry year risk for 2022.

We support the MBIE report's observation that the underlying cause of the 9 August event was inadequate visibility of discretionary load and not insufficient available generation to meet that winter peak. However, Transpower holds a public view that a problem with unit commitment was a contributing factor to the event. In engaging industry participants, we will specifically ask Transpower to clarify its position on both demand-side and supply-side risks and opportunities to support the system operator in balancing the system through winter peaks. In line with the MBIE report recommendations the Authority is actively managing the system operator and applying an assurance lens to the system operator's actions so the Minister, industry and consumers can have confidence in the actions taken. The Authority has also been scrutinising its relationship with

Transpower and will continue to hold Transpower firmly to the roles and contracts that bind it. In terms of unit commitment, the Authority is aware of such challenges faced in some international markets as they decarbonise, and we are considering this as part of the Wholesale Market Review.

The Authority has various workstreams underway that seek to address some of the more complex, industry-wide matters identified in the MBIE report including work by the Authority's Market Development Advisory Group (MDAG), which is investigating how the wholesale electricity market might operate under a 100 percent renewable electricity supply. An initial MDAG report in February 2022 defined relevant issues to be examined in detail. The MDAG work is examining whether current market arrangements are appropriate for the future (and will consider revenue adequacy for infrequently run plant, demand response and hedge products such as caps).

Wholesale market

Strengthening competition in the wholesale market is a key priority for the Authority. In addition to continuing to actively monitor and enforce the trading conduct provisions, the Authority has been consulting on its Review of competition in the wholesale market for the period January 2019 to June 2021, and the policy issues raised by the potential for inefficient price discrimination, as illustrated by the latest contracts with the New Zealand Aluminium Smelter at Tiwai. The Authority expects to undertake a further round of consultation on any proposed Code amendment arising from the issues paper on inefficient price discrimination in the first half of 2022, with decisions and any Code changes coming into effect in fourth quarter of 2022. Further, as we signalled in our briefing to you on this Review, wider recommendations, including for structural changes, are a possibility.

In 2022/23, as indicated in the Energy Transition Roadmap, the Authority expects to be undertaking a forward work programme informed by the Review of competition in the wholesale market. The work programme will be finalised in the second quarter of 2022, once the issues raised during the consultation have been considered. Activities will be prioritised which both support the transition, including incentives to invest in renewable generation and electrification of the economy, and which are in the longer-term interests of consumers.

Real-time pricing will be implemented in November 2022, which will ensure that wholesale prices reflect the actual prices at which electricity is supplied and purchased at the time of production or consumption. A key part of real-time pricing is dispatch notification, which enables low-cost participation in the wholesale market, including from the demand side, and its implementation is scheduled for the first quarter 2023.

Consumer protection

The Authority has begun considering the implications of the expected changes to the regulatory framework resulting from the Electricity Industry Amendment Bill and, in particular, the more explicit focus on protecting the interests of domestic and small business consumers. This will include a continued focus on monitoring that retailers' standard of service reflects the expectations set out in the Consumer care guidelines. The Authority will undertake a review of retailers' alignment with the Consumer care guidelines in mid to late 2022 to ensure the guidelines continue to be effective.

The Authority will continue to work alongside the Consumer Advocacy Council, the Energy Hardship Expert Panel and the Energy Hardship Reference Group and other stakeholders to increase our understanding of consumers and their needs. The Authority welcomes the opportunity to work with these groups to capture different consumer perspectives in the Authority's decision-making and ensure that electricity supply is meeting the needs of consumers.

Energy sector – readiness for change

The Energy Transition Roadmap sets out the work the Authority is planning to support a successful transition to a low emissions energy system. In 2022/23, the Authority expects to be responding to the MDAG's advice on market operation and investment with 100% renewable electricity, including options to improve market arrangements if required. The Authority is also expecting to begin

implementation of the programme to ensure the future security and resilience of the electricity system, so that operation of the system can successfully harness the opportunities from the expected substantial increase in distributed energy resources (DER), while maintaining reliable electricity supply.

The Authority is anticipating that, subject to consideration of feedback, we will be able to make decisions on a new Transmission Pricing Methodology (TPM) in early 2022, for an anticipated implementation date (by Transpower) of April 2023. Following a decision on a new TPM, the Authority will progress further Code changes as necessary to support successful implementation of the TPM.

The Authority continues to be focused on the distribution sector and its role in and preparedness for a low emissions economy.

The Authority is currently working to identify whether the regulatory settings for distribution networks need updating to enable competition between distributed energy resources (DER) and established technologies. Key to this is ensuring that consumers can participate, control their energy use, and contribute to New Zealand's emissions reduction, and that all consumers are able to benefit, not just those that invest in DER. In 2022/23, the Authority is expecting to confirm the issues and develop preferred options so that the flexibility and functionality from DER can be better utilised.

As part of this work programme the Authority is seeking improvements to distribution pricing. In December 2021, the Authority published more detailed guidance on efficient distribution pricing with an ongoing focus on driving efficient pricing outcomes for the distribution sector.

The Authority will look to continue to engage actively with MBIE, the Energy Efficiency and Conservation Authority, Commerce Commission, and Gas Industry Company, along with other relevant agencies such as the Climate Change Commission and Infrastructure Commission, to ensure the energy regulatory system supports innovation and consumer choice, including through the Council of Energy Regulators. As noted earlier, we expect the key focus for 2022/23 will be development of the Energy Strategy and successful implementation of the first Emissions Reduction Plan.

Organisational development

The Authority has recently completed phase two of a change programme that seeks to ensure we have the key capabilities and structure in place to respond to the increasingly complex and dynamic electricity sector. The changes ensure the Authority is well placed to meet the expectations set out in your letter. The People and Capability Workforce Strategy plan sets out how the Authority attracts, retains and develops the people resources to deliver on your expectations. This includes a strategy to embed effective succession planning and retention of institutional knowledge. The key challenge currently is competing in a volatile and tight State Sector labour market where competing employers have the resources to offer attractive employment packages.

The Authority also notes the need for Board appointments or reappointments in 2022.

Enduring letter of expectations and general governance expectations

The Authority is making an ongoing effort to meet the requirements set out in the enduring letter of expectations, including general governance expectations. As requested, we will provide information to MBIE about how these expectations are given effect through our business planning process. 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 provide comments below on the matters specifically referred to in Annex 1 of your letter.

Government Workforce Policy Statement

In line with the Government Workforce Policy Statement, we have recruitment practices in place that guide hiring managers to appoint on the basis of key skills and attributes rather than on the basis of age, gender or ethnicity.

We maintain up to date recruitment information on the intranet and have introduced a recruitment platform that ensures we are more transparent in how we advertise new opportunities internally and externally. All staff have access to the latest health, safety and wellness information, and over twenty employees have agreed to take part in an assessment of our health, safety and wellness practices with external consultants.

Public Service Pay Gap Action Plan

In preparation for the 2022 remuneration review, and working within the current pay restraint guidance, we are analysing salaries across each pay band and job family. To assist with a targeted action plan across age, gender and ethnic equity, the Authority is working more closely with Diversity Works (starting with a stocktake of current policies and practices) and with the guidance provided through regular meetings of the Public Service Heads of HR group.

Carbon Neutral Government Programme

Given the Authority's key role in driving low emissions in the electricity sector, the Authority is keenly aware of the importance of limiting net emissions from our own activities. We began calculating and reporting our emissions in 2020/21. Our procurement policy requires our procurement decisions take into consideration the transition to a net zero emissions economy, consistent with the Government's Procurement Rules. Travel comprises the single largest source of emissions from activities undertaken by the Authority. The Authority therefore makes a conscious effort to limit travel and, despite the easing of restrictions in response to COVID-19, intends to continue to favour virtual opportunities in order to limit our emissions footprint. We will continue to look for further opportunities to limit the emissions footprint of our activities.

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 welcomed the strong engagement with you and your office in relation to the events of 9 August 2021. Our intention going forward is to continue with this very constructive engagement with you.

Yours sincerely



Dr Nicki Crauford
Chair
Electricity Authority