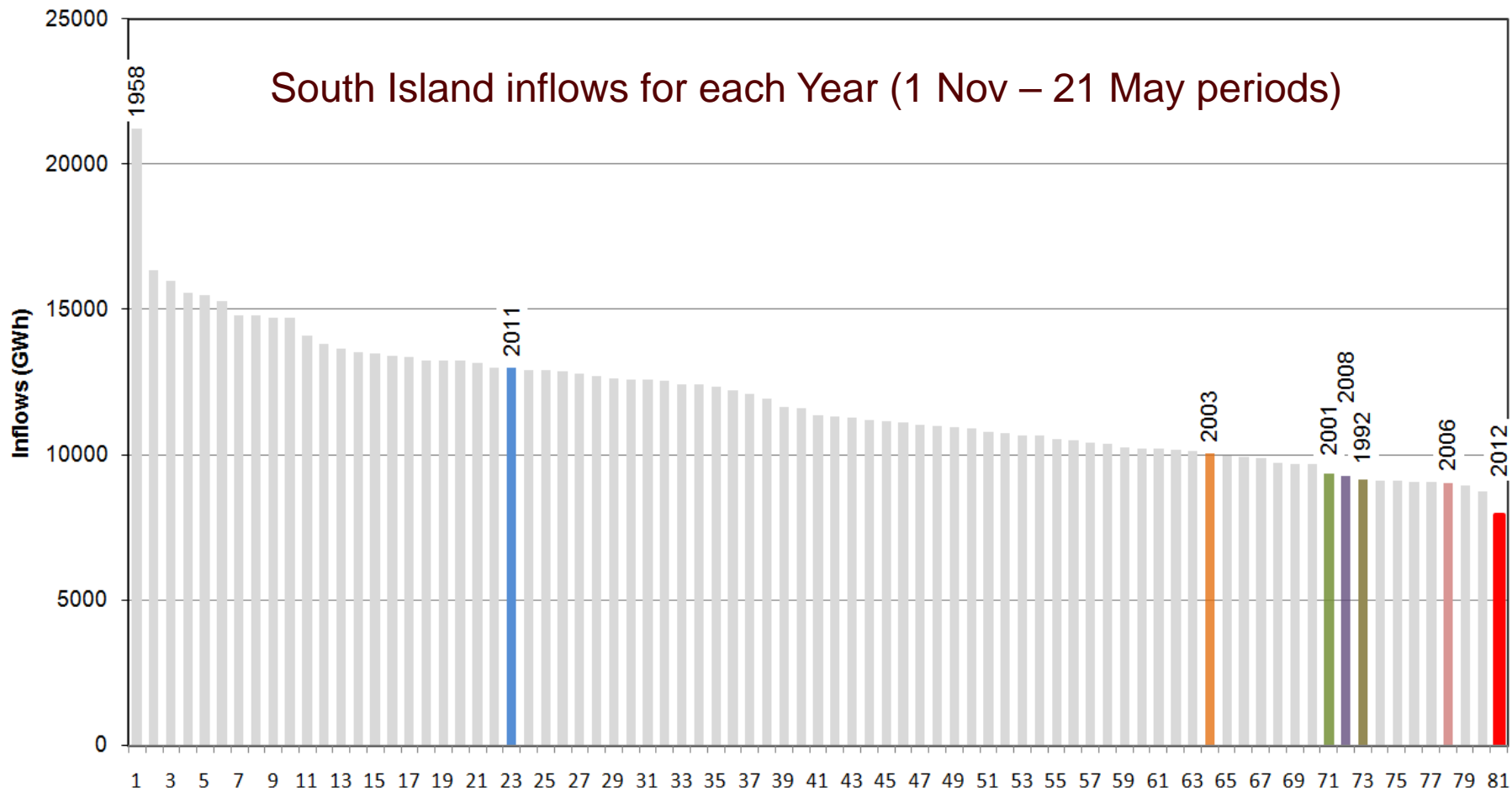


Enhancing electricity industry performance

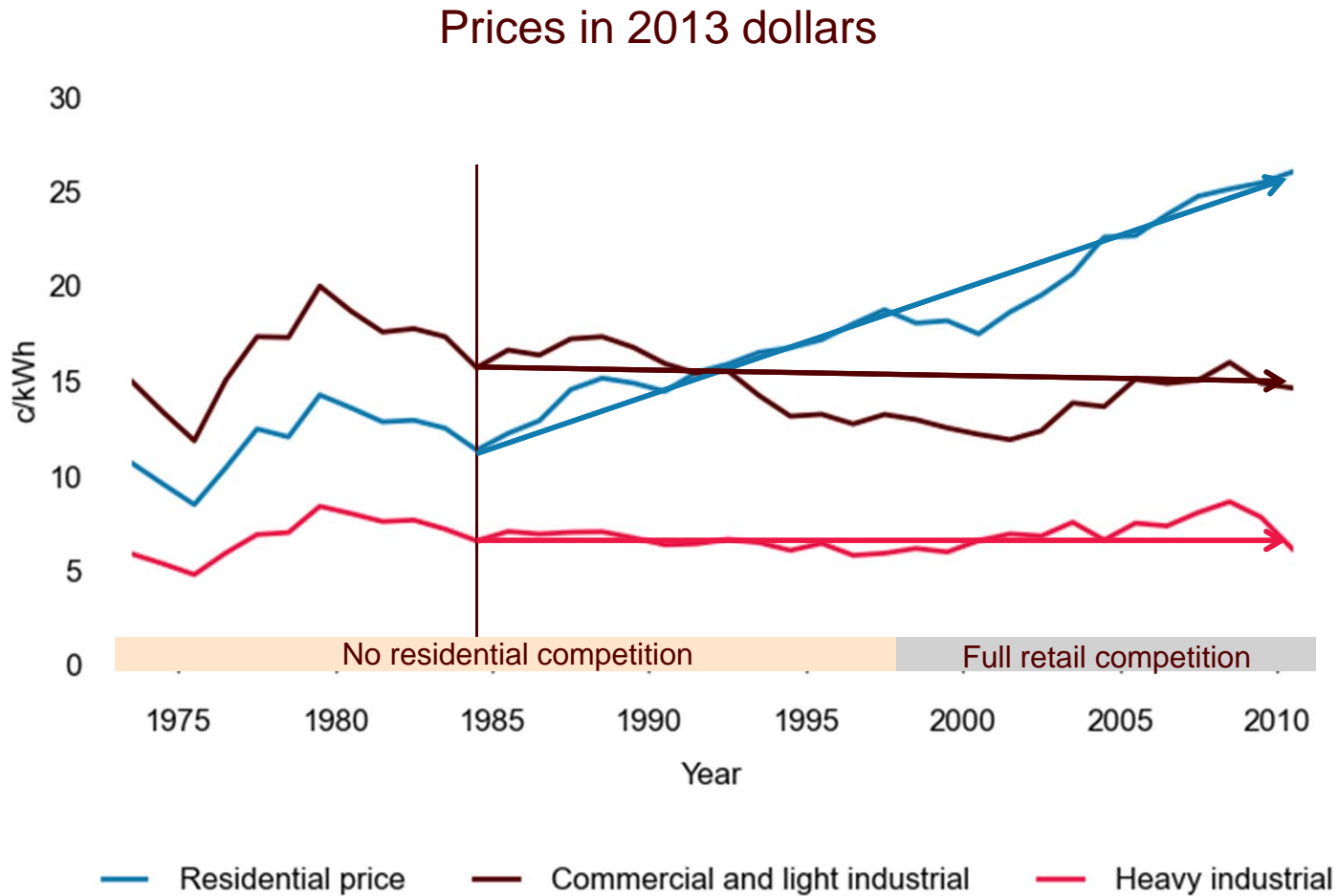
Presentation to BusinessNZ Energy Council
8 April 2014

The regulatory landscape for electricity in NZ

No longer having regular security of supply crises



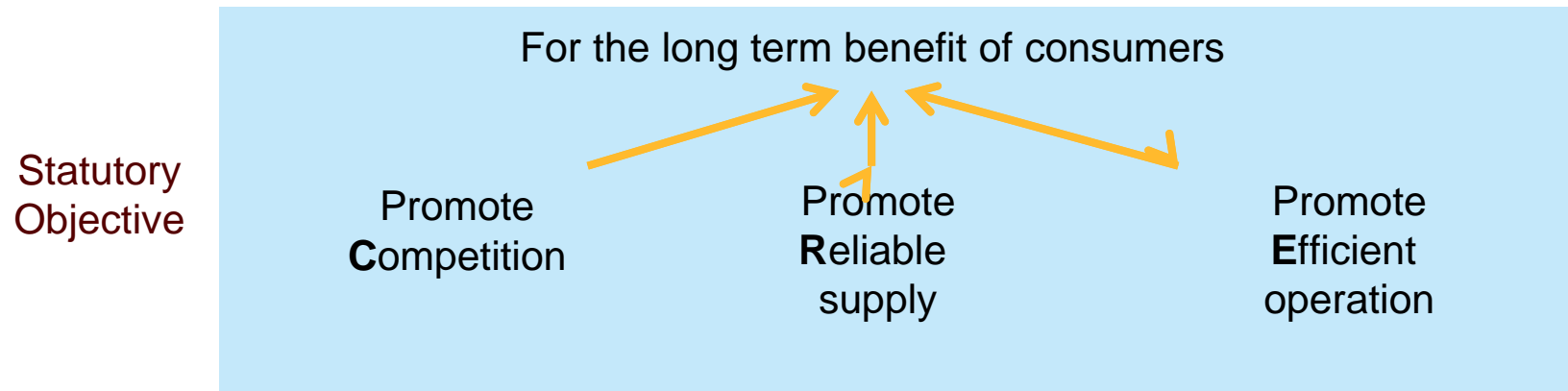
But it takes time for people to believe we have workable competition when their prices have risen sharply in real terms for a prolonged period of time



Broad support for a professional and independent rule-making body for electricity

- ❑ Electricity is very capital-intensive and a key infrastructure for the economy and society
- ❑ Large industrial energy users are also capital-intensive
- ❑ The Authority as an independent Crown entity
 - Other provisions set the skills required by Authority Board members
 - The Authority is required to have advisory groups with experience
 - Further checks are provided by requirement to undertake cost-benefit analysis and consult on proposed Code amendments
- ❑ These provisions were adopted to provide assurance that electricity industry rules would be developed and enforced based on impartial and professional analysis

The Authority's objective (s15 of the Electricity Industry Act)

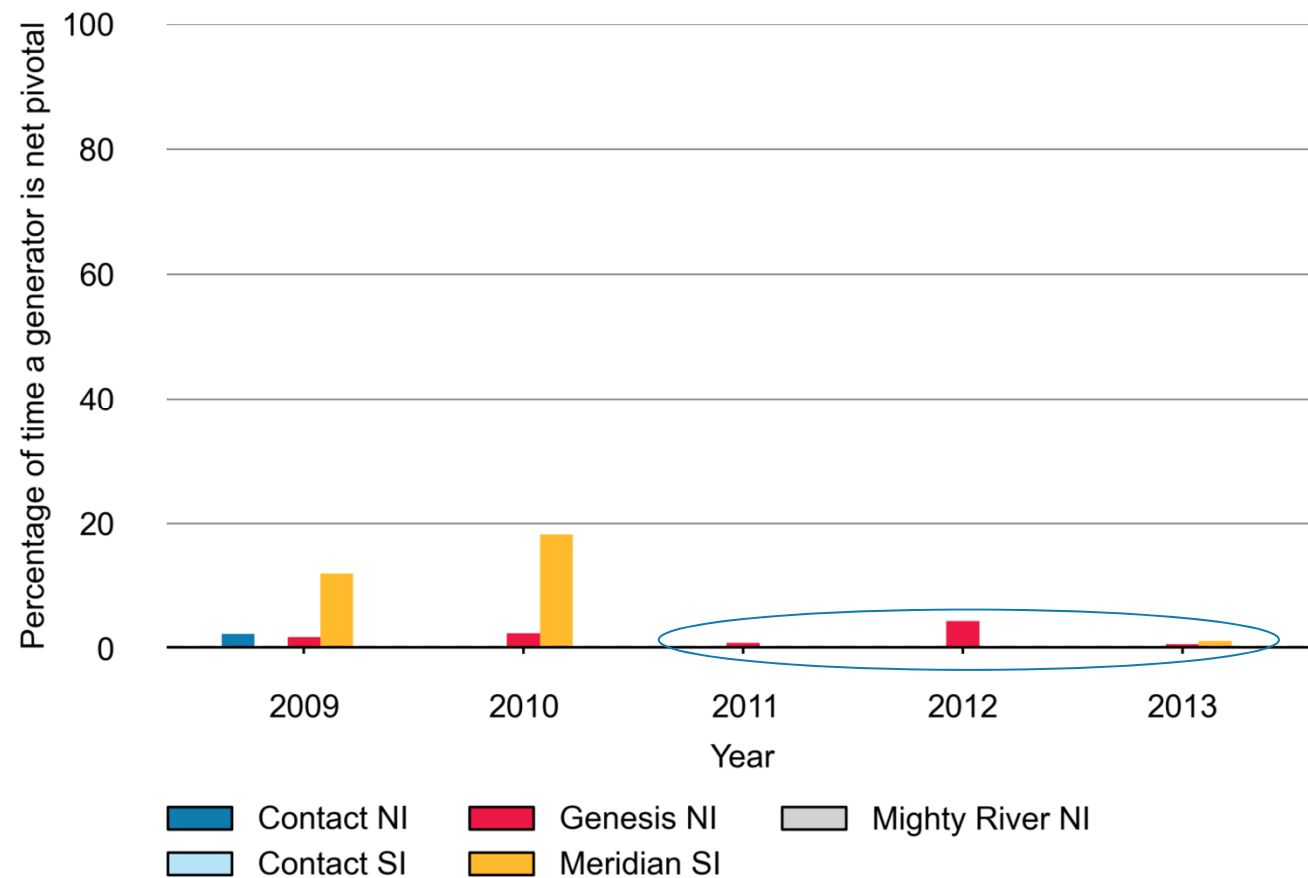


Why seek a workably competitive market?

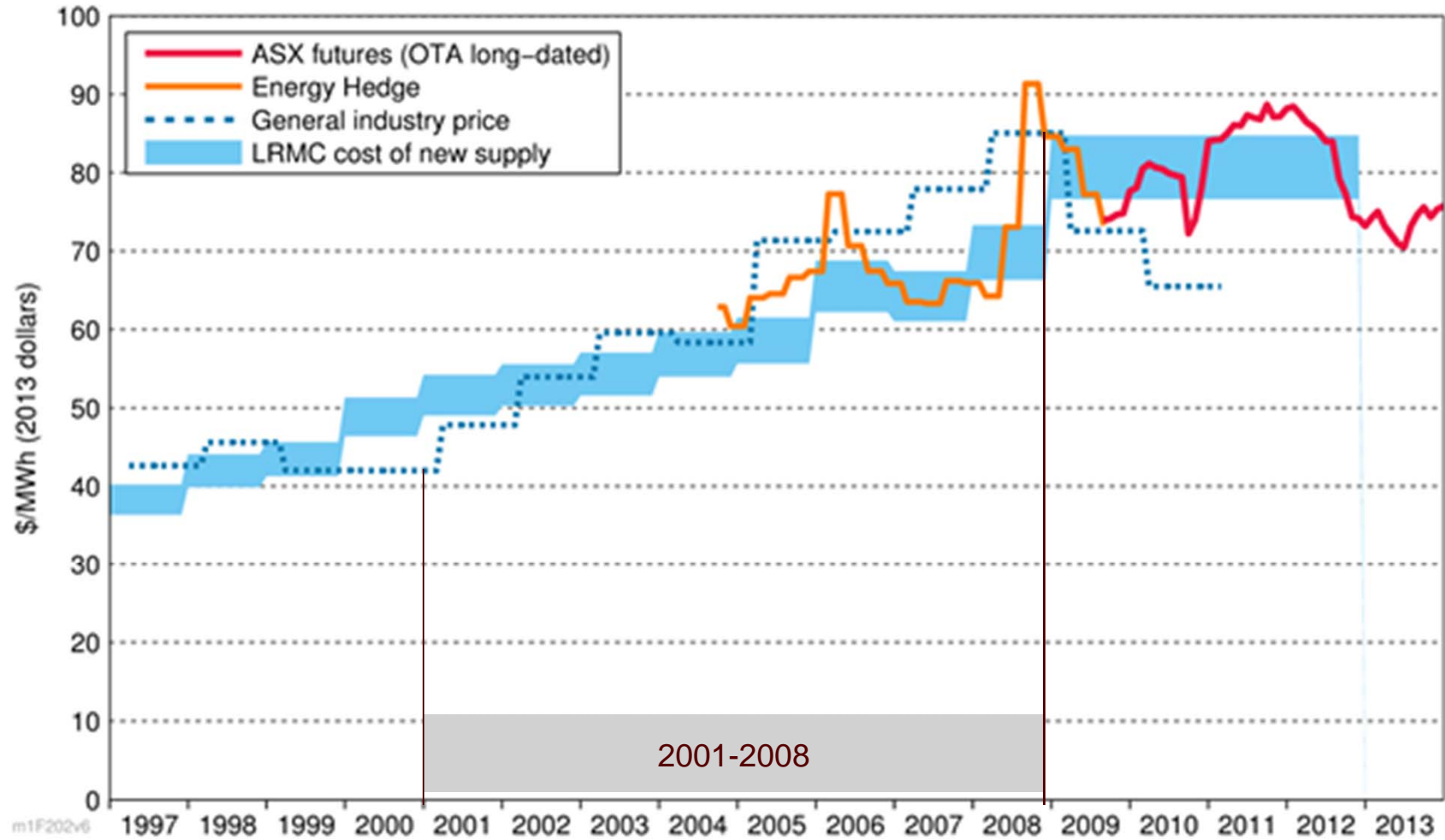
Workably competitive market	Perfectly competitive market
Ensures prices broadly reflect cost of supply (~allocative efficiency)	Prices always = marginal cost (allocative efficiency achieved)
Drives costs towards efficient levels (~productive efficiency)	Costs always = efficient costs (productive efficiency achieved)
Spurs innovation (~dynamic efficiency)	But there is no innovation

**What is the level of competition in NZ
electricity market?**

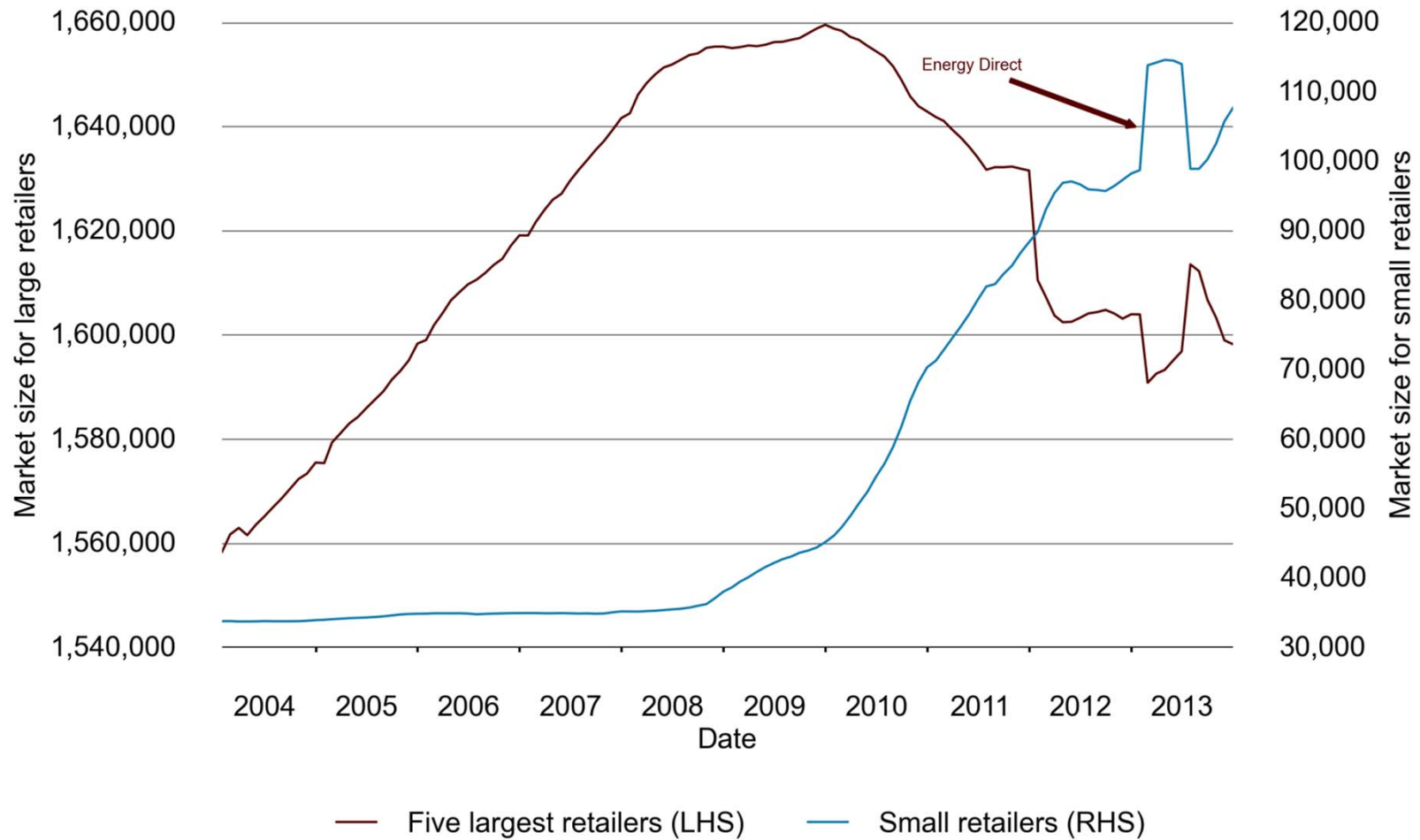
2009 reforms led to big fall in the ability of generators to unilaterally and profitably raise spot market prices



Wholesale prices broadly in line with rises in LRMC

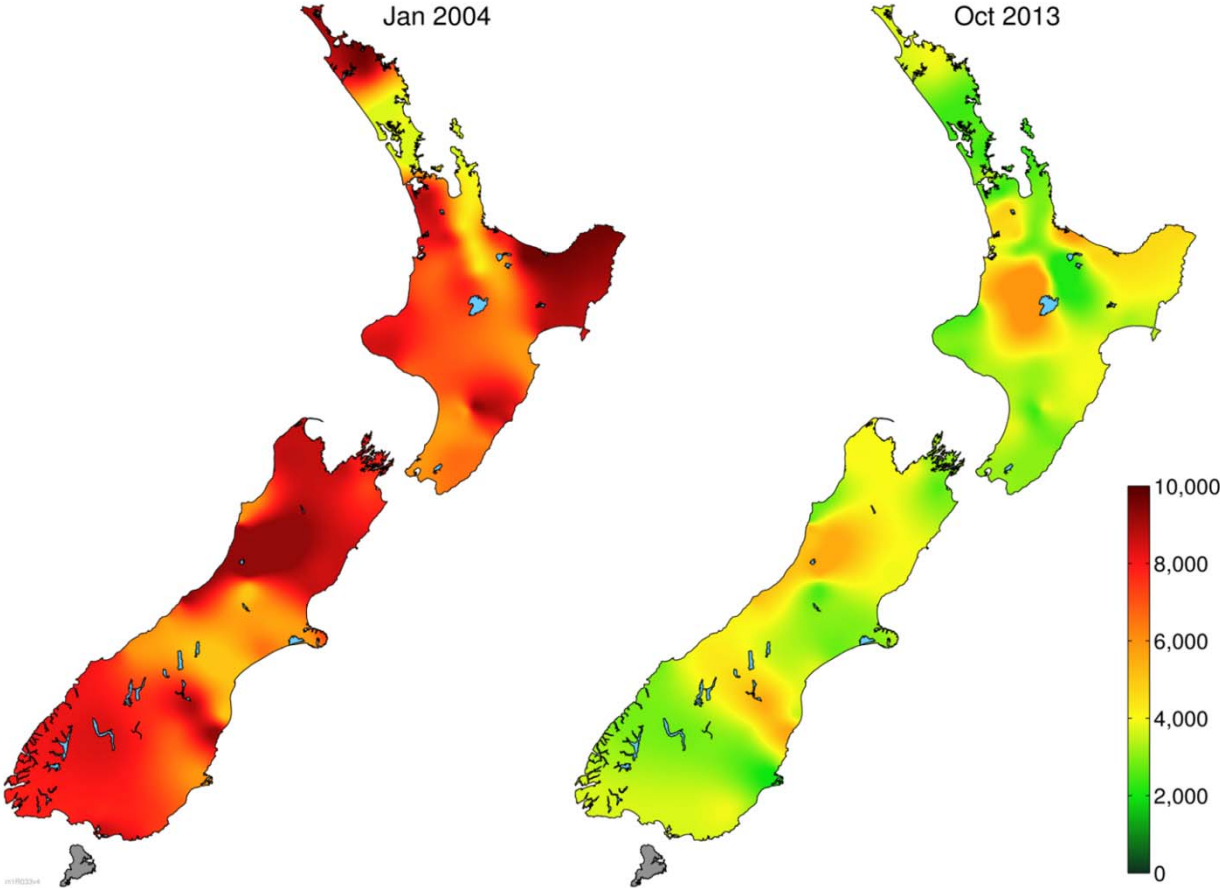


Small retailers have expanded rapidly since 2009



Retail concentration (HHI) has declined significantly

HHI = Herfindahl-Hirschman Index

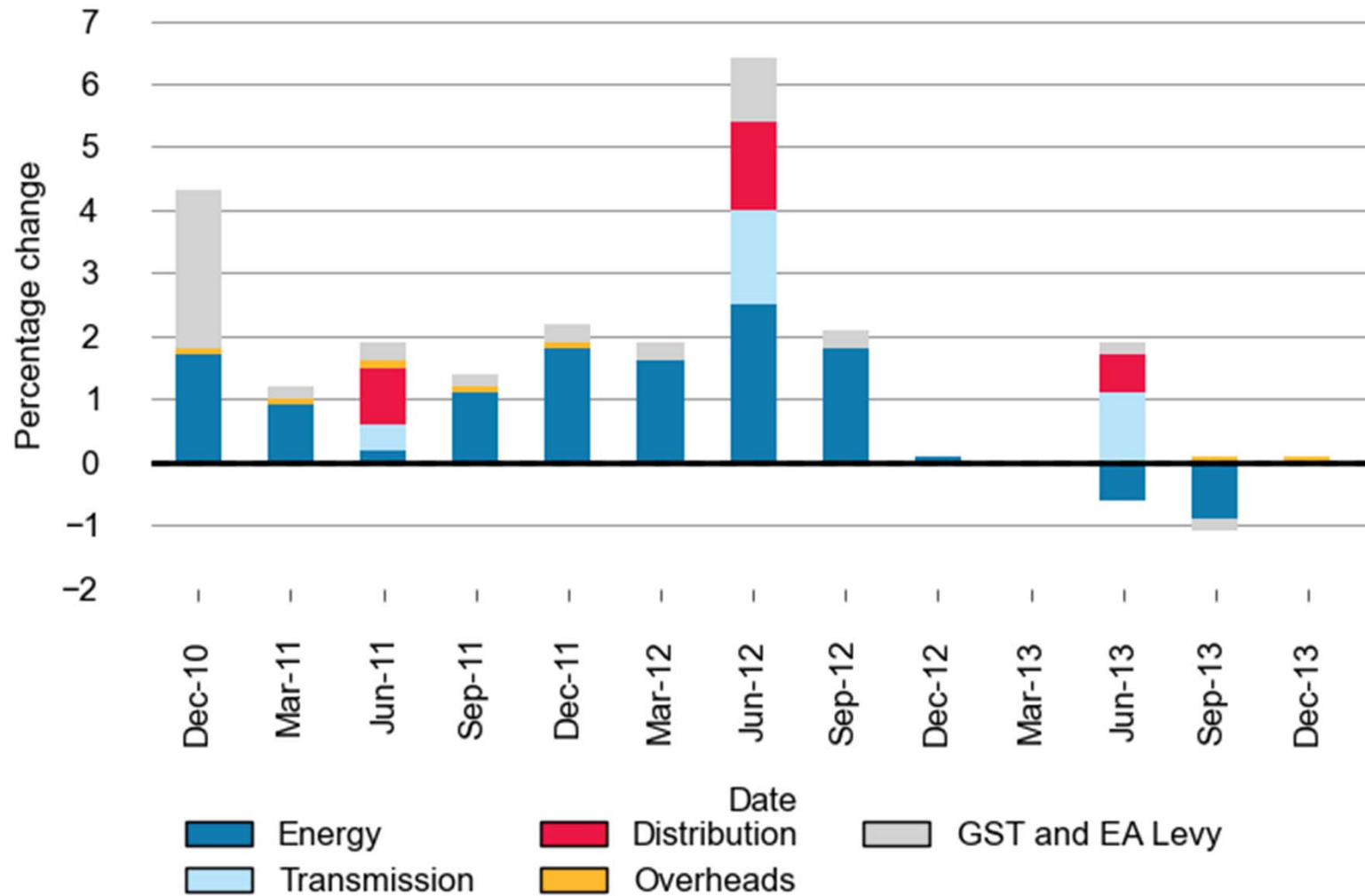


Increase in competitive pitching to customers

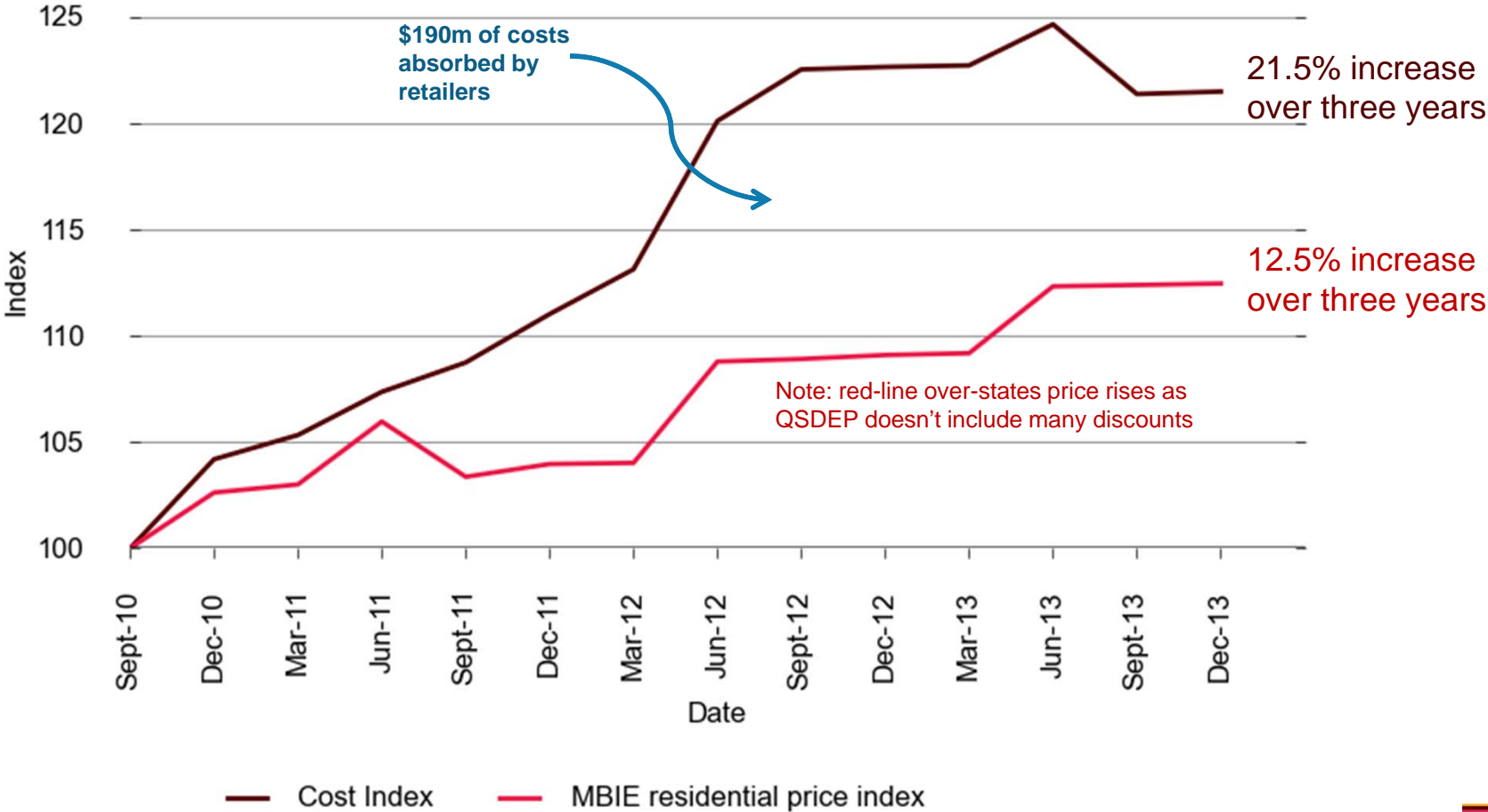
Survey question: How many times have you been approached by different power companies to switch to them in last three years?

	2011	2013	% change in rate
Approached twice	18%	23%	28%
Approached 3+ times	11%	19%	73%

Cost drivers for a stand-alone retailer



Costs for retailers rose faster over the last three years than residential prices: *implies a workably competitive market*

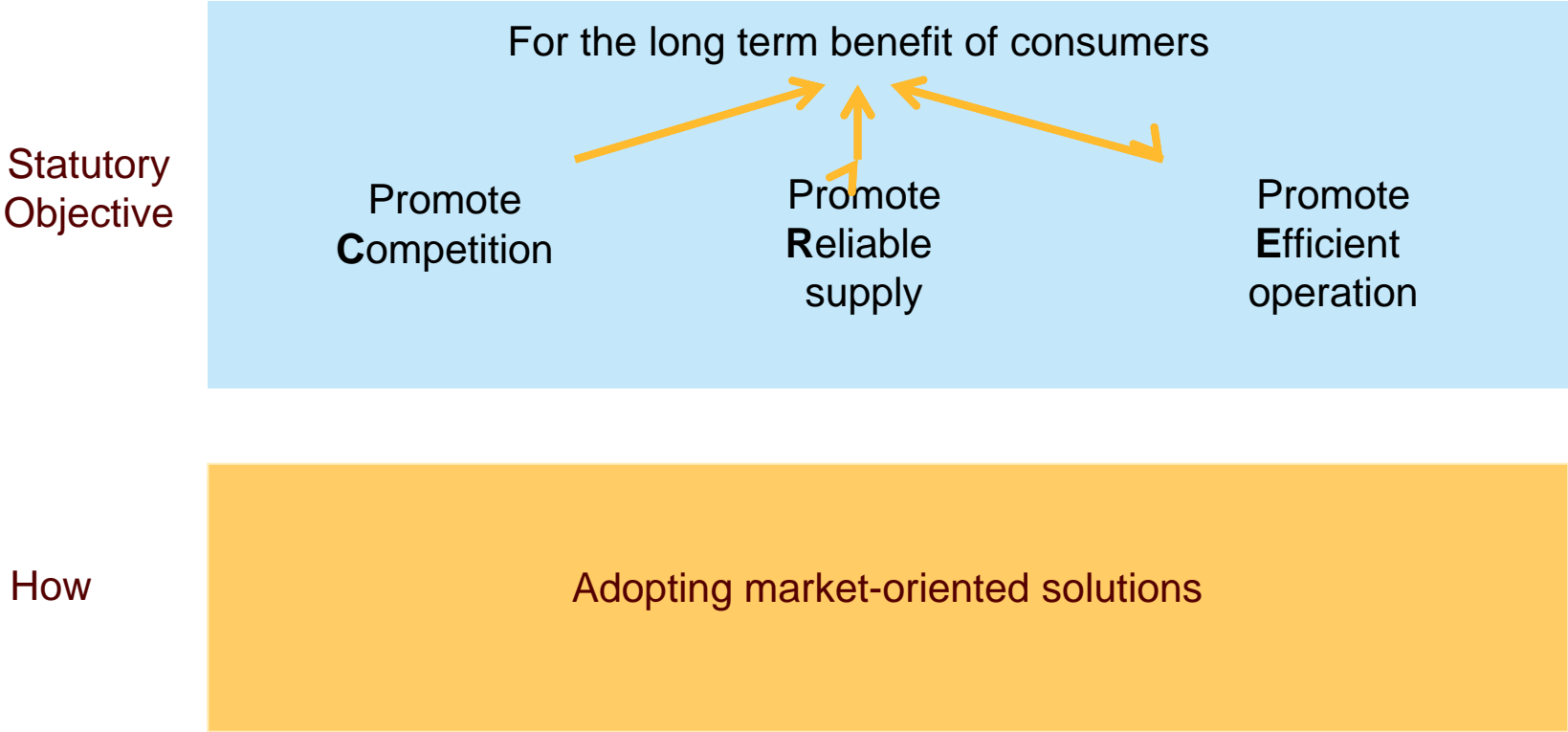


Conclusion: significant progress has been made in last few years

	Progress since November 2010
Security of supply	Passed two (dry year) tests: issues appear to be solved but still early days
Wholesale market prices	Competitive spot prices occurring 98% of the time due to the 2009 reforms Hedge prices < LRMC of new generation
Retail market prices	Competition greatly enhanced but more needed <ul style="list-style-type: none">• Sizeable price discounts offered to consumers that 'shop around'• But price rises for passive consumers
Innovation and efficiency	Innovation is flourishing Investment risk borne by investors Strong incentives for on-going efficiencies

How the Authority pursues its objective

How does the Authority pursue its objective?



Market-oriented initiatives since 2010

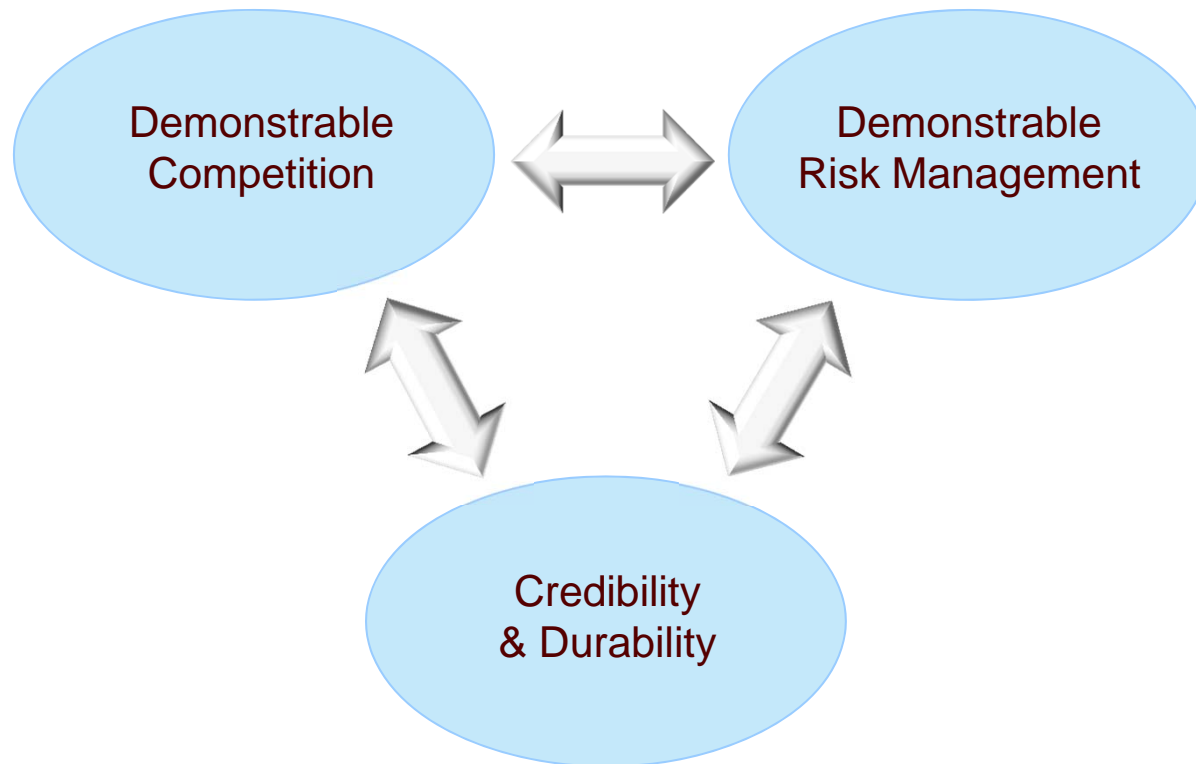
□ Structural initiatives

- Dispatchable demand regime
- Financial transmission rights
- New futures market products
- Multiple frequency-keeping
- Nationwide FK & IR markets
- Extended reserves “market”
- Switching tool for SMEs

□ Conduct-based initiatives

- Market-making on futures
- Information disclosure rules
- Prudential & settlement rules
- Pivotal pricing rules
- Mandatory UoSA rules
- EIEP rules
- Whats My Number campaign

The key regulatory challenge is to build the credibility of market arrangements for electricity



My top 5 regulatory challenges on the horizon

1. Engaging consumers and building their confidence in the market
2. Altering legacy pricing structures for residential consumers
3. Achieving a highly effective hedge market
4. Boundaries between the competitive and monopoly parts of the sector
5. When we get our first retailer default

Outside EA mandate

- Environmental and climate change concerns
- Poverty and struggling consumers

Discussion